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# International Financing Programs and U.S. International Economic Competitiveness

U.S. DEPARTMENT OF COMMERCE
International Trade Administration

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# INTERNATIONAL FINANCING PROGRAMS AND U.S. INTERNATIONAL ECONOMIC COMPETITIVENESS

U.S. DEPARTMENT OF COMMERCE
International Trade Administration

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# EXECUTIVE SUMMARY

On May 25, 1990, Congress mandated the Secretary of Commerce to examine the use of foreign assistance and other government international financing programs to advance national economic interests on the part of the United States, France, Germany, Japan, and the United Kingdom. The mandate also directed that mechanisms and ways be explored to enhance U.S. international economic competitiveness through such financing programs.

Chapter I describes the financing programs of the U.S. Agency for International Development, the Export-Import Bank, the Commodity Credit Corporation, the Overseas Private Investment Corporation, and the Trade and Development Program, together with their foreign counterparts. It is found that U.S. firms have access to government financing under several different programs for their export, foreign investment, and other business-related activities.

Chapter I notes, however, that some observers have perceived a lack of coherence among the U.S. programs. Particularly with regard to tied aid, they believe that U.S. economic assistance and business support functions tend to diverge instead of proceeding in an integrated and coordinated manner. Thus, the question has been raised as to whether AID can do more at the margin to support U.S. trade and investment interests. The objectives remain of attempting to enhance U.S. international competitiveness while establishing strong and vigorous AID programs.

Chapter II finds that developing countries received, net, over $100 billion in resources from all sources in calendar year 1988. Almost two-thirds consisted of official development finance, while one-third were private flows. Net export credit flows were low. By the late 1980s, official development finance had surpassed private and export credit flows to become the largest component of net resource flows to developing countries.

Bilateral Official Development Assistance (ODA) from the seven largest donors totalled $36 billion in 1987. The U.S. share, though large, was stagnant over time, while the levels of most of the other six donors were rising. In June 1990, the Development Assistance Committee (DAC) released provisional 1989 data indicating that, for the first time, the amount of U.S. net ODA disbursements fell to second place among DAC countries, after Japan's.

On aid-tying, the United States, with 45 percent of its aid funds reported as untied in 1987, is in the middle range of the seven major donor countries. Formal aid-tying is supplemented, however, by informal mechanisms to enhance the export reflows from aid; some such mechanisms are discussed. The study explores "additionality" strategies by aid recipients and donors and cites the views of a number of observers that donors' aid-tying can be enhanced by concentrating aid on capital projects and minimizing it on cash transfers and basic human needs projects.

On sector distribution, the seven major donors as a group devote a large share of their aid to purposes classified by the DAC as "Economic Infrastructure" and "Production." The lowest share is that of the United States, which directs 14 percent of its aid to transportation, communications, energy, agriculture, industry, mining, and construction. Italy and Japan spent over 60 percent of their aid in these sectors.

The regional distribution of aid reflects long-standing economic and geopolitical interests of donor countries, rather than commercial motives. Geographic ODA concentration in traditional markets tends to freeze out other countries' suppliers. On the other hand, a donor's historic geographic patterns constrain the flexible use of ODA to penetrate non-traditional markets where other donors predominate.

On an individual country level, however, some aid recipients have become known as "spoiled markets." They are seen to be blanketed with ODA tied to specific capital projects, such that concessional financing is essential or customary for capital goods sales. The same countries tend to be repeatedly named as spoiled markets and are the target of the most recent U.S. Government efforts to counter commercially-motivated tied aid.

Chapter III discusses three special topics: Financing for Eastern Europe, environmental protection in Eastern Europe, and U.S. tied aid policy. With regard to the first, the study finds that over $22 billion of financing has been pledged for Hungary and Poland during the past year, but cautions that these pledges should not, for several reasons, be considered as aid in the same sense as aid for developing countries. Around $11 billion of the total is earmarked for Polish debt relief and Stabilization Fund. The remainder is mostly in the form of export credit and investment insurance and guarantees on market-related terms; thus, ample resources appear available to sustain European and Japanese commercial activities in Poland and Hungary. Since a pattern of concessional lending has not yet surfaced for Eastern Europe, the terms of U.S. financing seem to be competitive, but the supply of U.S.

financing may need to be augmented if American firms are to have access to financing for their Eastern European business.

The environmental protection needs of Eastern Europe are described, and various approaches to safeguard the environment are outlined. U.S. firms, with a vast reservoir of pollution abatement technology and equipment developed over two decades of experience with domestic environmental problems, are in a position to assist Eastern Europe. Large amounts of financing will be required. Some $300 million of bilateral funds made available is a useful first step; additional financing can be expected as pollution control technology is incorporated in new facilities being built with financing under the general export credit lines.

U.S. policy on tied aid is reviewed. The overarching objective throughout has been to remove credit subsidy, including commercially-motivated aid, as an element of trade competition while maintaining a flow of resources on appropriate terms to needy developing countries. The evolution of U.S. policy and the introduction of limited financial countermeasures are described. The most recent countermeasure, in May 1990, is the creation of a joint AID/Eximbank $500 million pool of funds for capital goods financing in the spoiled markets of Indonesia, Pakistan, the Philippines, and Thailand.

Chapter IV recounts the views of private sector spokespersons. They emphasize the need for a national policy integrating aid and trade objectives and claim serious adverse impacts from tied aid on their business. Skepticism is expressed about the results of the U.S. negotiating strategy. Several underscore the importance of maintaining exports of capital goods and emphasize the developmental benefit of capital projects. The creation at AID of a financing facility dedicated to the financing of capital goods is recommended.

Chapter V explores the concept of a "Third Window" at AID as a basis for further joint development by Congress and the Administration. The Third Window, which would supplement the existing Development Assistance and Economic Support Fund at AID, would finance U.S. exports for capital projects in developing countries and not compete for resources against Basic Human Needs nor budgetary/commodity funds provided in the existing programs. The structure of the Third Window would enhance additionality and would be authorized at a modest percentage of development assistance appropriations.

# INTRODUCTION

Congress has mandated that the Secretary of Commerce conduct a study on the use of foreign assistance and other government international financing programs[1] to advance national industrial and commercial interests on the part of the United States, France, Germany, Japan, and the United Kingdom. Since such programs are directed mostly toward developing countries, the study concerns the developing countries as recipients of funds, as markets for the export of goods and services, and as potential sites for foreign direct investment. The study also explores mechanisms and ways to enhance U.S. international economic competitiveness. See Appendix A for the text of the legislation.

In responding to the issues raised by the legislation, this study addressses the following questions:

- What Federal international financing programs are available to support United States aid, trade, and investment objectives? What are their foreign counterparts; how active are they?

- What level of financial resources do developing countries receive? How do foreign assistance programs fit into the whole? To what extent do governments tie their aid, directly and indirectly, and by what practices?

- What can be said about recent extensions of financing for Eastern Europe and about environmental protection in the countries of that region? What is the Administration's policy approach toward curbing trade and aid distortions arising from tied aid finance?

- How does the private sector regard U.S. financing programs?

- In light of the above, what ways and mechanisms commend themselves for enhancing U.S. international economic competitiveness?

We would like to express our appreciation to our colleagues in the Government and the private sector, without whose active interest and collaboration this study would have been incomplete.

# I. U.S. FINANCING PROGRAMS

The chief international financing programs of the United States are those of the Agency for International Development, the Export-Import Bank, the Commodity Credit Corporation, the Overseas Private Investment Corporation, and the Trade and Development Program. The assistance of these agencies in preparing this chapter is gratefully acknowledged.

## A. Foreign Economic Assistance

The assistance programs of major industrial countries are intended to benefit the donor as well as the recipient. The United States emphasizes political and strategic benefits to the United States from its assistance programs as well as economic benefits to recipients, as distinct from economic benefits to U.S. exporters. As a recent General Accounting office (GAO) study noted:

> U.S. economic assistance has many officially designated goals but, with the exception of the Food for Peace Program, direct trade promotion is not a prominent consideration. In fact reducing donor country linkages between foreign assistance and trade promotion has been a U.S. policy objective since the mid-1970s. U.S. policy has emphasized addressing basic human needs and integrating developing economies into the international economic system. The Economic Support Fund is oriented toward advancing such goals in the interest of stability and security in countries of strategic/political importance to the United States.[2]

### 1. Programs and Procurement

The two main economic assistance programs directly administered by the U.S. Agency for International Development (AID) are the Economic Support Fund (ESF) and Development Assistance (DA) funds. In fiscal year 1990, these programs totalled $3.7 billion and $2.4 billion, respectively. The ESF is economic assistance resources deployed to support U.S. foreign policy and national security interests. Country allocations of ESF are determined by the State Department consistent with Congressional earmarks. Once this type of assistance is allocated, it is to be used by AID in accordance with the objectives provided for in law. DA funds are intended to promote economic growth in developing countries, improve the

lives of individuals in those countries, and encourage the development of democratic pluralism.

In addition, AID closely coordinates with the Departments of Agriculture and State on the operation of the $1 billion Food for Peace and Section 416 agricultural assistance programs (discussed separately in Section C of this chapter).

AID's basic charter is the Foreign Assistance Act of 1961, as amended (the "1961 Act"). Section 604 of the 1961 Act states that:

> funds made available under this Act may be used for procurement outside of the United States only if the President determines that such procurement will not result in adverse effects upon the economy of the United States or the industrial mobilization base...

In 1961, President Kennedy made a determination under Section 604(a) to allow procurement in less developed countries for reasons of trade and foreign policy and when it would make sense to do so. Procurement in industrialized countries was not entirely precluded under the Determination for "some commodities needed [and] not produced in the United States, or... not available in the quantities required at the time needed", provided that a waiver is obtained. The Kennedy determination did, however, recognize that the bulk of procurement would still come from the United States.

AID implements Section 604 through a complex series of procurement regulations. For most grants, procurement is restricted to U.S. or host country goods and services. For loans, the sources of procurement can be expanded to include imports from developing countries as well (including the recipient, where specified), but not from industrialized countries without a waiver. When assistance is provided as a cash transfer (as in the Israel program) or is disbursed against policy change in designated sectors, procurement source rules do not apply since no goods or services are financed.

Other broad exceptions to U.S.-only procurement are small individual amounts ($5,000 or less) which may be procured locally without a waiver and blanket waivers for items not manufactured in the United States, such as right hand drive vehicles. In the past, procurement restrictions have been relaxed for entire projects or parts of projects.

Recently, the Administrator of AID decided to eliminate authorizations for local procurement at the project approval

stage which has served as a de facto blanket waiver for AID missions abroad to procure locally without signing any waiver. To replace this system, the Administrator authorized a system of transaction-specific waivers which would be signed by AID mission directors abroad both for project approvals that include local procurement and for individual transactions.

Additionally, the Administrator has made it clear that lack of detailed expenditure data showing both the source and origin of all AID procurements is unacceptable. A new data system to get these data will be implemented as part of a new AID "Buy America" policy.

AID's policy now is to provide most program funds in the form of grants, though a very small amount of loans are still being extended. AID's ability to promote U.S. exports is constrained by the nature of its programs, not by the grant/loan mix of funding. These constraints are embodied in the 1961 Act itself and related legislation which govern AID's actions.

2. Development Assistance

Functional Development Assistance Program (FDAP): AID currently has eight separate accounts designed for particular kinds of activities worldwide: Agriculture, Rural Development and Nutrition; Health; AIDS Prevention and Control; Child Survival; Population Planning; Education and Human Resource Development; Private Sector, Environment, and Energy; and Science and Technology. For fiscal year 1990, more than 27 percent of the FDAP is earmarked for specific purposes while legislative directives and targets cover another 32 percent. FDAP money is provided on a grant basis, so in principle most transactions (except those with the relatively least developed countries) are tied to U.S. goods and services.

The FDAP accounts use U.S. exports, but rely heavily on local procurement of goods and services. For example, a recent AID study of AID Mission expenditures in Thailand showed that less than 20 cents of every AID DA dollar spent returned to the United States through U.S. goods and services purchased. Due to the purposes the functional accounts serve, however, U.S. aid does not promote U.S. exports in sectors where competition from other aid programs is a factor, except in limited cases. Most purposes addressed by FDAP aim at increasing human capacities and providing services directly to people in developing countries. Typical U.S. exports financed include consulting services, studies, and training; some construction equipment (for rural road projects), education-related equipment, and renewable energy equipment.

Another factor limiting the export promotion effect of the FDAP accounts is the amount of host country costs ("local costs") they finance. Although AID usually estimates local costs

covered as between 21 and 25 percent, the GAO has suggested that the figure is nearer 30 percent.

The Development Fund for Africa (DFA): In 1988, AID's development assistance programs for sub-Saharan Africa were freed from functional account requirements. Though still subject to certain earmarks and restrictions, the DFA is a much more flexible program than the FDAP. The DFA also differs from functional accounts in that it is nominally untied. Although the law governing the DFA program promotes the untied nature of DFA funds, it also contains language encouraging AID to buy U.S. goods and services where possible.

The DFA has funded a number of regional transportation projects resulting in the export of U.S. railway and other transport equipment. Commodity import programs are used to encourage economic reform in African countries. Greater utilization of the DFA as an export promotion tool is currently limited by its untied character, lack of U.S. exporter interest in Africa and the poverty of African countries which has prompted the Congress and the Administration to concentrate on immediate human needs in the region.

3. Economic Support Fund

Resources provided under the ESF may be in the form of cash grants, project financing, or commodity import programs.

Cash Transfers: Cash transfers presently make up nearly 60 percent of the ESF program. ESF cash grant agreements usually specify the permissible uses of the grant but do not limit U.S. goods and services purchased to specific exporters. Some agreements do have "off-set" provisions requiring the host country to import goods and services from the United States equal to the cash provided.

Cash is fungible and hard to associate with any given export, regardless of any side agreement on permissible uses. AID has moved to tighten reporting on the uses of cash transfers; separate accounts and dollar tracking now permit AID to determine what U.S. aid is used for. Although cash grants are considered to be untied under the international statistical reporting system, the GAO has questioned the continued classification of ESF cash as untied given the "separate account" provisions currently in place.

Projects: Egypt, Pakistan, and the Philippines and a few other countries are the sites for AID-financed capital projects, often in sectors such as power, transport, and urban infrastructure with good export follow-on potential. Grant financing is tied to U.S. procurement except for local costs. This type of AID financing is better suited than others to increase the Agency's activities in support of exports. For

this reason ESF project financing is being used in conjunction with Eximbank financing to promote U.S. exports in Pakistan and the Philippines under the May 1990 AID/Eximbank Cooperative Program. Projects currently account for about 30 percent of ESF funds in any given fiscal year.

Commodity Import Program (CIPs): CIPs make up less than 10 percent of ESF funds, with Egypt having the largest program. CIPs finance the export of U.S. goods to recipient countries, but in most cases are less than perfect tools for market penetration and/or increasing market share. Generally, a wide range of CIP-eligible commodities do not build an aid focus on U.S. exports in key commercial sectors such as energy, transport, and telecommunications, thus limiting their impact on gaining a market foothold. U.S. CIP restrictions are in the form of a short list of forbidden products (such as weapons and nuclear materials) Other donors, in order to target financing to specific exports of greatest commercial interest to their firms, may limit procurement to a list of eligible commodities to ensure that even "untied" procurement largely flows back to the donor country.

4. Comparison with Other Donor Programs

The 1989 Eximbank analysis exhaustively explored the ways in which donors combine aid with export credit to promote exports in key sectors. However, the economic assistance funds used in this manner form only a small percentage of the major donor programs. Most of the export promotion impact in other donors' programs comes from the ordinary operations of their economic assistance programs.

Formal tying provisions are a common feature among all major donors; U.S. tying regulations are comparable to those of competitor countries. It is not tying restrictions as such, but other factors which cause U.S. assistance programs to have a significantly lower export promotion impact.

As Chapter II discusses, a major difference between U.S. programs and those of other major donors is program focus. Data compiled by AID (in accordance with international data reporting directives) indicate that U.S. financing of capital and infrastructure projects is the lowest of the major donors (about 6 percent in fiscal year 1990). These are exactly the areas where export competition is most severe and where U.S. exporters allege that they are losing the most business. It is not "tied aid" as such that makes the difference; much of U.S. aid is tied. It is the program focus of other countries on capital projects which gives them major competitive advantage over the United States.

This does not mean that other countries' aid programs are "not really" about development. Their capital projects programs are

for the most part developmentally sound and address infrastructure constraints to economic development in host countries. Virtually all major donors have programs in areas such as agriculture, health, and education. However, other donors provide most of these types of assistance through multilateral agencies, which are expected to put recipient interests first, while concentrating more of their aid in sectors of commercial interest. The U.S. approach since the 1970s has been to rely on multilateral agencies to finance capital infrastructure while concentrating direct U.S. assistance to meet basic human needs and promote economic policy reform-- areas where the commercial interest is relatively small.

Technical assistance, including training and studies, is common to all major donor programs. U.S. technical assistance emphasizes empowering people in developing countries to carry out sustainable, environmentally sound development on their own behalf. Other donors, however, target technical assistance more toward activities that use exports.

Other donors may take more specific action to target assistance by recipient and type to benefit the donor economy. France offers a good example of this strategy. Those developing countries having a long-term cultural and political relationship with France receive concessional loans from the Caisse Centrale and budget support, technical cooperation, and training under the Fonds d'Aide et de Cooperation. In relations with other developing countries, France concentrates on mutual economic benefit by combining concessional loans from the Tresor (Treasury) with guaranteed export credits to finance capital projects. The Japanese aid program concentrates heavily on capital projects in Pacific Rim countries. The choice of countries is influenced by not only proximity to Japan, but also their role as providers of key raw materials and other goods.

## B. Export Credit

The Export-Import Bank of the United States (Eximbank) is an independent U.S. Government agency, with the primary purpose of facilitating the export of U.S. goods and services. Eximbank meets this objective by providing loans, guarantees, and insurance coverage to U.S. exporters and foreign buyers, normally on market-related credit terms. Eximbank support, which is only for U.S. exports, helps foreign buyers of U.S. goods and services to secure the financing needed to conclude their purchase.

Unlike other U.S. Government agencies discussed in this chapter, Eximbank programs are not oriented toward development

objectives, but toward addressing financial market imperfections constraining trade finance for commercially-oriented export sales.

1. Eximbank Programs

Eximbank support is available for a wide array of U.S. export sectors. The extent of financing depends on product characteristics and the competitive nature of individual transactions.

Eximbank's guarantee and insurance programs are structured to encourage private financial institutions to fund U.S. exports by reducing the commercial risks (such as buyer insolvency and failure to pay) and political risks (such as war and currency inconvertibility) such institutions perceive in trade finance. The financing made available under Eximbank's guarantees and insurance is on market terms, and most of the commercial and political risks are borne by Eximbank.

Eximbank's loan program, on the other hand, is structured to neutralize interest rate subsidy offered by foreign governments. By responding with its own subsidized loan assistance, Eximbank enables U.S. financing to be competitive with that offered by foreign exporters.

Short-term: Eximbank supports export sales requiring a repayment term of up to one year under its short-term insurance program: if the foreign buyer fails to repay the credit, Eximbank reimburses the exporter. Products covered include consumer goods, commodities, spare parts, and raw materials. Exporters seek Eximbank insurance for short-term exports if they are unwilling to assume the commercial and/or political risks. Short-term insurance activity amounted to $5 billion and $4 billion in fiscal years 1988 and 1989, respectively.

Medium-term: Medium-term exports consist of products sold on repayment terms of one to five years. These products include vehicles, mining and construction equipment, machine tools and equipment, and project-related services.

Insurance, guarantee, and loan support are available for medium-term sales. Insurance and guarantees (essentially similar programs) reduce the political or commercial risks of financing. Medium-term loans counter below-market interest rates offered by competitor governments. Eximbank support for medium-term export credit amounted to some $700 million and $1 billion in fiscal years 1988 and 1989, respectively.

Long-Term: Long-term exports include commercial jet aircraft, power plants, manufacturing plants, and other large projects. Both guarantees and loans are available for long-term export sales requiring a repayment period between five and twelve

years. Guarantees provide financial institutions lending at market interest rates with Eximbank's unconditional commitment to pay if the borrower does not. Loans offset competing, subsidized loans from a foreign government. Long-term loan and guarantee activity was $790 million and $1.4 billion in fiscal years 1988 and 1989, respectively.

The amount of subsidy under Eximbank's regular loan programs has been substantially reduced over the past decade. Under internationally-accepted ground rules, governments of the major industrialized countries finance exports on market-related terms and conditions. In many or most cases, private financing suffices. The threshold for subsidized interest rates in effect from July 15, 1990, through January 15, 1991, on newly-approved loans depends on the destination of the export, as shown in Table I-1.

Table I-1: Current Arrangement Interest Rates
(From July 15, 1990, to January 15, 1991)

| | Repayment Term | |
|---|---|---|
| | Up to Five Years | Over Five Years |
| Wealthy Markets | Only market rates | Only market rates |
| Intermediate Markets | 10.05% | 10.55% |
| Low-income Markets | 9.20 | 9.20 |

Concessional Financing: While normal Eximbank financing is on market-related terms, the Bank has extended concessional financing in selected cases to support the objective of eliminating trade-distorting tied aid credits for commercial purposes. Eximbank concessional financing is aimed at strengthening U.S. negotiating efforts to achieve broad and permanent change in the international rules governing tied aid credits. The extent of Eximbank's tied aid activity has closely followed the course of negotiations-- when negotiations are active, the level of Eximbank tied aid credit activity increases-- and limitations on the budgetary resources available to the Bank.

A key difference between Eximbank and its foreign counterparts is the close working relationship other export credit agencies have established with their aid authorities. By contrast, the coordination between U.S. foreign assistance and export credit agencies has, until recently, been tenuous. Chapter III details the negotiating history and tied aid countermeasures.

## 2. Foreign Export Credit Agencies

Most developed countries whose exporters compete against U.S. exporters for foreign sales have an export credit agency that

provides financing similar to Eximbank's.[3] The techniques for accomplishing this result reflect long-established banking traditions and institutional patterns and vary widely among countries. They include outright subsidy payments and complex mechanisms for preferential access to credit. The following table shows long-term export credit activity by seven governments. It should be interpreted with care, as exporter reliance on government financing depends in major part on the adequacy of private financing facilities in the home country.

Table II-2: Volume of Export Credit Activity
(Repayment Term over Five Years, $ Million, Calendar Years)

| | 1989[a] | 1988 | 1986 | 1982 |
|---|---|---|---|---|
| All OECD Countries | $9,776 | $12,914 | $9,447 | $20,747 |
| Seven Major Countries | 8,450 | 11,147 | 8,037 | 17,972 |
| United States | 1,574 | 618 | 1,435 | 2,217 |
| France | 2,278 | 5,552 | 3,195 | 4,929 |
| Germany | 786 | 1,167 | 285 | 2,247 |
| Japan | 683 | 513 | 1,266 | 3,436 |
| United Kingdom | 761 | 754 | 886 | 2,803 |
| Canada | 745 | 644 | 434 | 1,644 |
| Italy | 1,623 | 1,899 | 536 | 696 |

[a]Preliminary, March 1990.

Source: Eximbank, from data reported to the OECD

A brief description of Eximbank's principal foreign counterparts follows:

France: The Banque Francaise du Commerce Exterieur (BFCE), a government-owned agency, is the lender for officially supported export credits at preferential interest rates. The Compagnie Francaise d'Assurance pour le Commerce Exterieur (COFACE), a quasi-public company, insures credit repayment. These two agencies implement French export credit policy, which is formulated by the Direction des Relations Economiques Exterieures.

Concessional financing is provided by the French Government through the Caisse Centrale de Cooperation Economique (CCCE) and government-to-government protocols. CCCE support consists of loans and grants extended to former French colonies. Most CCCE financing is used for capital projects and tied to

procurement from France. Protocols are concessional lines of credit for multiple projects or transactions. They are generally entered into annually between France and those beneficiary countries that are ineligible for CCCE financing. Protocols generally combine concessional loans from the Tresor (French Treasury) with officially-insured commercial export credits and are usually tied to French procurement.

Germany: German export insurance and guarantees are issued by a consortium consisting of Hermes Kreditversicherungs, a private insurance company, and Treuarbeit AG, a quasi-public corporation. Insurance/guarantee support from the consortium mobilizes funding from private banks. Larger export credit contracts are discussed in an interministerial committee (Interministerieller AusschuB), with the Economics Ministry making a final determination as to whether the guarantee is available.

The German Government's development assistance program is directed by the Ministry for Economic Cooperation (BMZ). Policy is implemented primarily by the Kreditanstalt fur Wiederaufbau (KfW), which channnels capital assistance for economic development in developing nations, and by the Deutsche Gesellschaft fur Technische Zusammenarbeit (GTZ), which provides technical assistance. Two other major sources of German development finance are the German Finance Company for Investments in Developing Countries (DEG), and the type B (B-plafond) export credits of the Ausfuhrkreditgesellschaft (AKA), a consortium of 55 German banks.

Japan: The Export-Import Insurance Division (EID) of the Ministry of International Trade and Industry (MITI) is responsible for providing export credit insurance coverage for Japanese exports. EID support enables commercial banks, normally unwilling to assume the risk of foreign long-term financing, to fund overseas projects. The Export-Import Bank of Japan provides guarantees to banks and provides loans to complement commercial bank financing for Japanese export sales.

The Ministries of Foreign Affairs (the lead agency), Finance, and International Trade and Industry, and the Economic Planning Agency formulate development assistance policy and approve development assistance loans. Implementing agencies are the Overseas Eccnomic Assistance Fund, which provides project loans, and the Japan International Cooperation Agency, which provides technical and other grant funded assistance.

United Kingdom: The Export Credit Guarantee Department (ECGD) of the Department of Industry and Trade is the primary source of official export credit. Besides providing insurance and guarantees to protect British exporters and private lenders against payment default risks, ECGD operates an interest rate subsidy program. The latter assures a commercial rate of

return to lenders through an interest rate make-up scheme. ECGD pays the lender the difference between market rates and any below-market interest rate extended to the buyer.

The Special Committee on Aid and Trade has oversight responsibility for British tied aid programs. This committee includes the Department of Trade and Industry, the Overseas Development Administration, H.M. Treasury, the Foreign and Commonwealth Office, the Bank of England, and ECGD. ECGD's participation in tied aid credit transactions is customary, since the subsidy is partly provided through ECGD's interest rate subsidy program.

Canada: The Export Development Corporation (EDC) is the source of export credits from the Canadian Government, providing loans, guarantees, and insurance to buyers of Canadian exports. EDC operates under two separate accounts: (1) the corporate account for transactions where the risk lies with EDC; and (2) a national Canadian account for cases deemed too risky by EDC's Board of Directors but which the Canadian Government, through the Minister for International Trade, considers to be in the national interest. Tied aid credits are provided under the national Canadian account, which may be mixed with standard export credits, and through the Canadian International Development Association-- AID's counterpart.

Italy: The Sezione Speciale per l'Assicurazione del Credito all'Exportazione (SACE), under the guardian authority of the Treasury, insures credits for Italian exports against political, catastrophic, and commercial risks as well as exchange rate risks, while Medicredito Centrale, a public financial institution, provides financing.

The Italian Government initiates tied aid credits through government-to-government protocols, rather than on a case-specific basis. The Italian tied aid credit scheme is formulated by the Interministerial Committee on Development and Cooperation, consisting of the Ministries of Foreign Affairs, Budget and Economic Programming, Foreign Trade, and Treasury. In considering project eligibility for tied aid credit support, account is taken of the commercial aspect of a transaction with consideration given to market share and the importance of the sector to the Italian economy. This policy is implied rather than stated.

## C. Agricultural Export Finance

The Commodity Credit Corporation (CCC) of the U.S. Department of Agriculture (USDA) finances U.S. agricultural exports to developing countries through a number of programs including GSM-102, GSM-103, Public Law 480, and Section 416 donations. The two GSM programs make available over $5 billion of credit

at market interest rates. The Public Law 480 and Section 416 programs provide another $1 billion of support through grants or concessional financing. The agricultural products financed under CCC programs are exclusively of U.S. origin.

Besides its financing programs, the USDA operates the Export Enhancement Program to challenge unfair foreign agricultural trade practices, several small, commodity-specific subsidy programs (the Sunflowerseed Oil Assistance Program and the Cottonseed Oil Assistance Program), and a Direct Sales program that sells CCC-owned commodities abroad; these agricultural export programs are beyond the scope of this study.

1. U.S. Financing Programs

GSM Export Credit Guarantee Programs: The CCC began to provide commercial export credit financing in 1956 under authority of the Commodity Credit Corporation Charter Act (Public Law 80-806). Initially, the financing took the form of "direct" credits where the CCC purchased export accounts receivables. In the late 1970s, the CCC largely ceased operating its direct credit program and introduced its export credit guarantee facilities.

The GSM guarantee programs operate where credit is needed to increase or maintain U.S. exports to a foreign market and where private financial institutions are unwilling to provide financing without CCC's guarantee. The CCC currently facilitates private commercial financing to foreign buyers of U.S. agricultural commodities by providing guarantees to U.S. exporters (or U.S. commercial lenders) for credit terms of up to 3 years under the GSM-102 program and up to 10 years under the GSM-103 program.

The CCC currently guarantees 98 percent of the export value and 4.5 percentage points of the accrued interest under GSM-102, and a variable portion of the interest under GSM-103 based on a 52-week U.S. Treasury Bill rate. The CCC considers requests for guarantee allocations from foreign buyers, foreign government buying agencies, or U.S. exporters. Requests must specify the commodity, quantity, estimated value, shipping period, the credit period, and the foreign bank issuing the letter of credit.

The Food Security Act of 1985 requires CCC to make available at least $5 billion in guarantees each year through fiscal year 1990 for GSM-102, and at least $500 million in guarantees a year through fiscal year 1988 and not more than $1.0 billion in each of the fiscal years 1989 and 1990 for GSM-103. In 1989, 27 countries used the GSM-102 program and 13 countries used the GSM-103 program; a total of 32 countries used either or both. The largest GSM-102 programs were in Algeria ($690 million), Egypt ($350 million), Iraq ($1.05 billion), Korea ($560

million), Mexico ($1.13 billion) and Venezuela ($300 million). The largest GSM-103 programs during the same fiscal year were Jordan ($65 million), Mexico ($135 million) and Morocco ($121 million).

P.L. 480: The Agricultural Trade Development and Assistance Act of 1954 (Public Law 480) was originally enacted to help reduce large agricultural surpluses. Since its inception, over $39 billion worth of U.S. farm products have been shipped overseas. About half was wheat and feedgrains; other major commodities included cotton, soybean oil and nonfat dry milk. Some of the largest country programs were undertaken with India, Pakistan, South Korea, Egypt, South Vietnam and Indonesia.

In fiscal year 1990, 24 countries signed P.L. 480 Title I/III agreements worth over $660 million. Major recipients for this fiscal year include Bangladesh, Egypt, Morocco and Pakistan. The largest monetary outlays have been for wheat, oil, rice, feedgrains and wheat flour. Other commodities exported under P.L. 480 during fiscal year 1990 included vegetable oils, tallow, cotton and wood.

Title I, the concessional sales program, enables developing countries to buy U.S. agricultural commodities on long term credit for dollars, with payments extended over as long as 40 years at concessional interest rates. Recipient countries sell the commodities internally and use the proceeds for agricultural and economic development projects.

Under Title II, food commodities are donated to impoverished countries to help alleviate shortages of food resulting from drought, war, and natural disasters. More than $8 billion has been donated under this program since its inception in 1955. Roughly two-thirds of the tonnage shipped under title II is donated through nonprofit U.S. voluntary agencies, but Title II donations are also made directly to recipient governments, mostly for emergency feeding programs.

Title III allows foreign governments to purchase U.S. agricultural commodities on Title I terms and resell the commodities in their own countries. They then use the proceeds from these sales (or the commodities themselves) for self-help projects which increase farm production; improve storage, transportation, and distribution of farm products; or improve the quality of rural health and nutrition under family planning programs. Use of the proceeds for the approved development purposes is considered payment under the Title I agreement, effectively converting the Title I financing into a grant.

Section 416(b): Section 416(b) of the Agricultural Act of 1949 makes available for donation overseas certain minimum quantities of CCC's uncommitted stocks of grains, oilseeds and

dairy products for each of the fiscal years 1986-1990. The commodities can be furnished either as a direct donation or under the Food for Progress Act of 1985 (see below). The receiving countries must have adequate storage capacity, and imports of the commodities must not interfere with the usual marketing of agricultural commodities. In 1988, 18 countries received commodities under Section 416(b), the total CCC cost of which was $252 million.

The Food for Progress Act of 1985 authorizes the President to provide food to countries that commit to private, free market policies for agricultural development. Assistance may be provided on a multi-year basis through the authorities of Title I of P.L. 480 or Section 416(b) of the Agricultural Act of 1949. To receive commodities, a country must promote economic freedom, domestic food production for local consumption, and efficient domestic markets for locally produced commodities. The country also must be able to use the U.S. commodities without disrupting the internal marketing of domestic commodities.

2. Foreign Export Financing Programs

France: Since 1946, the French Government has assisted exporters through COFACE, which provides short-term commercial risk insurance of less than three years. COFACE also provides insurance of 3-7 years for political and commercial risk on behalf of the French government. Products must be primarily of French origin, but may contain up to 40 percent foreign content from other EC countries, up to 30 percent foreign content of global non-EC origin, and only 10 percent foreign content from any non-EC country. Coverage ranges from 85 to 100 percent of the export value, depending on the type of guarantee.

United Kingdom: The United Kingdom has not used significant levels of credit guarantees for agricultural exports. ECGD guarantees credit through two facilities, the Short Term Comprehensive Guarantee and the Supplemental Extended Terms Guarantee. The former covers credit terms of up to 180 days, while the latter covers exports on two year terms which may be extended to three years if there are competing exporters. An exporter may also use an existing line of credit extended by a United Kingdom bank and guaranteed by the ECGD. Finance Contracts Endorsements (FINCOBE) for the Extended Terms guarantee are also available. These provide export credit insurance through a United Kingdom bank rather than directly from the ECGD. Under both of these alternative programs the buyer pays 15 percent directly to the exporter, and the bank pays the remainder.

Italy: SACE administers export credit guarantees. In 1988, agricultural exports under the program accounted for $116 million. All agricultural exports are eligible, but local

costs and foreign content may not exceed the 15 percent cash payment required for the guarantees. SACE insures 90 percent of political and 90 percent of commercial risk for supplier credits. SACE also covers 95 percent of political and commercial risks for buyer credits and 100 percent for buyer credits involving intergovernmental agreements.

Canada: Export assistance is available through two government agencies, the Canadian Wheat Board (CWB) and EDC. CWB credit, which is fully guaranteed, is provided to the exporter on terms that are generally from 6 months to 3 years. CWB credit is only available for 100 percent Canadian-origin wheat and barley. In general, approximately 11 percent of Canadian wheat exports are financed through the CWB program. EDC, which guarantees all non-CWB exports, has provided credit guarantees totaling U.S. $600 million over the past five years. EDC offers both short-term (1 year) and medium-term (3 years) credit guarantees.

## D. Investment Facilitation

Encouraging U.S. private investment in developing countries has long been an important part of the U.S. Government's overall development assistance program. It is now recognized that foreign private investment helps relieve debt service problems in developing nations, supplements aid and commercial lending flows, and fosters a vigorous, market-based host country economy. The Overseas Private Investment Corporation (OPIC), a self-sustaining U.S. Government development agency, was created to mobilize and facilitate the participation of U.S. enterprise in the development process.

OPIC programs complement U.S. foreign assistance efforts and result in the transfer of much-needed capital, technology, and managerial skills while contributing to economic growth, employment, and private sector development in developing countries. These developmental benefits are not accomplished at the expense of U.S. economic interests, however. OPIC legislation requires that the effects of OPIC-assisted foreign investment do not harm the U.S. economy and employment. In addition, OPIC requires the projects it supports to have a substantial share of American participation. When co-investors include foreign entities, only the U.S. investment is eligible for OPIC insurance.

### 1. Principal OPIC Programs

In facilitating U.S. investment overseas, OPIC operates several major programs: political risk insurance, financial services, and special investment encouragement activities.

Insurance: Many U.S. investors are reluctant to take advantage of promising investment opportunities in developing nations in light of the perceived levels of political and economic instability. OPIC reduces the risk of catastrophic loss by providing insurance against inconvertibility of currencies, expropriation, and loss caused by political violence (war, revolution, insurrection, and civil strife). The availability of such insurance can be a prerequisite to some overseas investments by U.S. firms.

Besides supporting equity investment, OPIC has long offered specialized insurance and financial services programs for the exploration, development, and production stages of energy and mining projects that help meet world demand for natural resources while generating income for developing countries. OPIC also protects U.S. contractors and exporters against arbitrary drawdowns of letters of credit they must post as bid, performance, or advance payments bonds. In addition, OPIC insures and finances long-term cross-border leases to encourage developmentally beneficial transfers of U.S. technology and capital equipment. OPIC can also insure management agreements, branch capital for U.S. banks, and many other types of investments by U.S. firms.

More recently, OPIC initiated business income coverage to protect U.S. investors from loss of income due to political violence that interrupts operations. OPIC has also fostered debt-to-equity swaps with political risk insurance for transactions involving the creation of new investment projects. OPIC has begun to play a larger role in facilitating privatization of state-owned enterprises of developing countries through insurance coverage and financing.

Financial services: OPIC services include direct loans to projects involving U.S. small businesses and loan guaranties to private U.S. long-term lenders, thereby removing one of the major constraints to U.S. investment in the developing world. U.S. lenders may be reluctant to lend in developing countries because of lack of previous experience, cost factors, or regulatory or self-imposed limits on amounts that can be lent in one country. Also, U.S. lenders are often unwilling or unable to accept certain political risks.

OPIC makes financing available to U.S. investors, particularly small investors or those with little previous foreign investment experience, who may find it difficult to obtain commercial financing for investments in developing countries. OPIC also provides medium-term debt financing to establish or expand distributorships overseas.

OPIC recently developed an innovative financing vehicle, its new "growth funds", to provide equity or quasi-equity investment for new productive ventures, expansion of existing private sector companies, and privatization of state-owned

enterprises. Such funds can provide a critical hard currency equity component required to complete the financial structure of a project as well as meet foreign currency requirements, including those needed for debt swaps and conversions.

The first of these, the Africa Growth Fund, was implemented in sub-Saharan Africa and managed by Equator Bank. OPIC is currently endeavoring to create two additional funds-- the $200 million Eastern European Growth Fund and the $100 million Environmental Investment Fund. The latter fund will invest in private business in Asia, Africa, Latin America, and Eastern Europe that demonstrates a positive, mutually reinforcing relationship between profitable economic development and protection of the environment. For both funds, a business connection with one or more U.S. companies is required through direct ownership, management of a company, licensing agreement, marketing agreement, or supply of equipment and services.

Investment Encouragement Activities: OPIC also provides services that encourage wider participation in overseas investment by smaller U.S. businesses. These services include: investment missions, which bring U.S. investors in touch with local government officials and potential joint venture partners; a computerized data bank, which can match an investor's interest with possible joint venture partners and specific overseas investment opportunities; and investor information services, which provide investors with a wide range of information about foreign countries and their business environment.

2. Activity Levels

OPIC's insurance and financing authorization levels for fiscal year 1986-89 are given in Table I-3. Outstanding OPIC insurance ranged between $1.4 billion and $2.1 billion, well within the statutory limit of $7.5 billion throughout the period. On the other hand, the finance programs' annual authorities have generally increased over the same period. The fiscal year 1989 direct loan and loan guaranty authorities were $23 million and $175 million respectively, considerably increased over fiscal year 1986 levels. OPIC's authorized financing levels were fully utilized throughout this period.

The number of projects and aggregate investment actually supported by OPIC's programs have shown generally increasing trends over the years. In fiscal year 1988, OPIC insured or financed 167 projects around the world, the highest level in over 15 years.

3. Foreign Counterparts

Statistics indicate that growth in foreign direct investment by U.S. businesses over the long term declined relative to their

Table I-3: OPIC Authorization Levels and Program Activities
(Fiscal Years 1986-89)

| | 1986 | 1987 | 1988 | 1989 |
|---|---|---|---|---|
| Insurance | | | | |
| Insurance issued ($ billion) | $1.4 | $1.8 | $2.1 | $1.5 |
| No. of Projects | 104 | 144 | 156 | 115 |
| Financing | | | | |
| Authorized levels ($billion) | | | | |
| Direct Loans | $0.014 | $0.023 | $0.023 | $0.023 |
| Loan Guaranties | $0.136 | $0.200 | $0.200 | $0.175 |
| Finance Committed | limit | limit | limit | limit |
| No. of Projects | 29 | 31 | 18 | 21 |
| Total | | | | |
| Project Investment ($ billion) | $1.2 | $2.3 | $3.0 | $3.3 |
| No. of Projects[a] | 124 | 165 | 167 | 123 |

[a]The insurance and finance projects do not sum to the total line as some projects received both forms of OPIC assistance.

Source: OPIC

competitors from other industrialized countries. This trend appears to be more the result of well planned/financed investment promotion of the competition than of relative macroeconomic factors such as exchange rates.

A historical comparison of OPIC insurance and financing programs with those of some major counterparts abroad is given in Tables I-4 and I-5. These tables are limited to the 1985-86 period. Nonetheless, the current competitiveness of the foreign programs in terms of fees, interest rates, scope, activity levels, etc. relative to OPIC is likely to have remained the same or even improved.

Some of the more significant comparisons of OPIC and its major counterparts, which continue to be relevant today, are highlighted below:

- Japan has the largest portfolio of investment insurance, followed by OPIC. Japan's performance is attributed to such factors as a greater volume of investment, lower premiums, a distribution concentrated in the relatively creditworthy nations of Southeast Asia, coverage for commercial as well as political risk, and fewer policy restrictions.

- Japan's financing portfolio is also the largest among the group. In 1985-86, OPIC's level of direct financing ranked a distant fourth behind Japan, Germany, and the United Kingdom.

- Many foreign programs do not serve the same purposes as OPIC, putting U.S. business at a competitive disadvantage. OPIC's programs are more directed toward host country development, while foreign programs are designed primarily to serve domestic business interests.

- Unlike OPIC, the majority of its foreign counterparts are not entirely self-sustaining. Accordingly, many of them can offer more generous terms and conditions to business than OPIC.

- OPIC's counterparts are able to rely upon funds borrowed from government treasuries, thus enabling them to lend at concessionary terms and use part of their funding for equity investments.

- Direct project financing, a labor-intensive effort, required staffs of 258 and 195 to operate the German and U.K. programs, respectively, in 1985. In comparison, OPIC operates its finance program with a staff of about 30.

- In addition to political risk insurance and financing, the foreign programs provide loans and/or grants to conduct feasibility studies.

Table I-4: Political Risk Insurance Programs
OPIC and Its Major Counterparts

| | OPIC | France | Germany | Japan | U.K. | Canada |
|---|---|---|---|---|---|---|
| Outstanding Insured Investment, 1985 ($ million) | $4,707 | $ 234 | $1,382 | $7,827 | $ 157 | $ 43 |
| Percentage of OECD-Insured Foreign Direct Investment | 32.4% | 1.6% | 9.5% | 51.1% | 1.1% | 0.3% |
| Average Rates (% Annual Premium) | 1.65 | 0.4/0.7 to 1.0 | 0.5 | 0.55 to 1.75 | 0.7 to 1.0 | 0.9 to 1.4 |
| Host Country Restriction/ Mandates | Host Cntry Approval; Restricted in Richer LDCs | COFACE: none BFCE: LDCs | LDCs w/ Legal Protectns for FDI | None | None | None |
| Home Country Restriction/ Mandates | U.S. employment; Performance Requirements Export Promotn | Export Promotn | Development German FDI Promotn | Access to Raw Materials Export Promotn | Development | Promote Econ Relations |
| Other | Development | None | None | None | None | None |

Source (partial): Ghadar Associates, "A Study Comparing OPIC's Political Risk Insurance Program with the Official Risk Insurance Programs of Japan and France", 1988.

Table I-5: Finance Programs:
OPIC and Its Major Counterparts

| | OPIC | Germany | Japan | United Kingdom |
|---|---|---|---|---|
| Self-Sustaining | Yes, w/in context of Insurance Prog. | No | No | No |
| Outstanding Loan/Guaranty Portfolio | $590 mil. (FY 1985) | $400 mil. (FY 1985) | $7.1 bil. (FY 1986) | $1.1 bil. (FY 1983) (incl equity) |
| Annual Lending Commitments (Direct & Guar) | $150 mil. (FY 1986) | $41 mil. (FY 1983) | $722 mil. (FY 1985) | n/a |
| (Direct only) | $15 mil. (FY 1985) | $42 mil. (FY 1985) | $650 mil. (FY 1985) (Jexim only) | $142 mil. (FY 1985) (incl equity) |
| Lending Rates | Commercial | Commercial | 5% (Near Commercial) | n/a |
| Equity | No | Yes | JExim: No<br>OECF: Yes | Yes |
| Guaranties | Yes | Yes | JExim: No<br>OECF: Yes | No |
| Feasibility Studies | No (since 1985) | Yes | Yes | Yes |
| Technical Assistance | No | Yes | Yes | Yes |
| Training | No (since 1985) | No | No | Yes |

n/a = Not available

Source: Ghadar, Fariborz, ed. Financing third world development: A summary of official prject finance programs in OECD countries. Washington, D.C.: International Law Institute, 1987.

## E. Trade and Development Program

The Trade and Development Program (TDP), established in 1980, is an independent Federal agency under the aegis (together with AID and OPIC) of the International Development Cooperation Agency. TDP's activities emphasize U.S. responsiveness to host country development needs; enhance the competitive position of U.S. suppliers for follow-on procurement; are consistent with the policy objective to untie financing in developing countries; and support U.S. private sector participation in development projects around the world.

TDP funds project planning activities, such as feasibility studies, training programs, and reverse trade missions, in support of major projects in middle-income and developing countries classified as "friendly" by the Department of State, where there is a good potential for export of U.S. technology, goods, and servcies. Contracts funded by TDP grants must be awarded to U.S. companies.

Through fiscal year 1988, TDP has obligated $113 million for planning major projects. Its recent authorization levels were:

| | |
|---|---|
| 1989 | $25 million |
| 1988 | 25 |
| 1987 | 20 |
| 1986 | 18 |
| 1985 | 21 |

TDP considers proposals in all industry sectors where U.S. companies are competitive, but emphasizes those sectors in which the United States has a particular strategic interest and/or technical competitive edge. Such sectors include telecommunications, energy, transportation, trade-related training, and environmental protection technologies.

All TDP projects must have high development priority to the host country so that they are likely to be implemented if the feasibility study is positive; must present an opportunity for substantial sales of U.S. goods and services; and must have access to a source of funding for project implementation with procurement open to U.S. firms.

TDP's principal program is to fund or finance feasibility studies and consultancies to determine the technical, economic, and financial feasibility of proposed projects in developing countries. Such studies often provide detailed data and specifications used in deciding how to proceed with project

implementation. Most projects are undertaken by governments, but TDP will support private sector projects in which a U.S. investor plans to take equity. TDP's support for U.S. participation at the project planning stages maximizes the potential for follow-on U.S. exports when the project is built.

TDP grants are untied as to follow-on procurement, but $2.8 billion of U.S. exports to date have been associated with projects involving TDP-funded studies. More recent TDP studies are expected to realize substantially greater U.S. exports in the next several years.

TDP also funds training to enable managers, engineers, and technicians from developing countries to implement a project and operate and maintain the facility after construction. Training contributes to the developing country's skilled manpower base, familiarizes the host country with U.S. equipment, and creates goodwill. Training grants may provide a pivotal inducement that results in an export contract being awarded to an American firm.

Related TDP activities include funding for visits by host government officials to the United States to acquaint them with U.S. technology, conferences and seminars to advise U.S. firms about export opportunities in a sector or geographic area arising from TDP-funded feasibility studies, and meetings at the state level to generate grass-roots interest in exporting.

Other industrialized nations have programs similar to TDP's. Specific data on the size of these programs are not generally available. Moreover, because the programs, though similar, are not directly comparable to TDP, any information obtained is not easily reconciled with TDP activity levels.

The Japan International Cooperation Agency (JICA) in 1987 had an overall budget of over $1 billion for grant programs, of which $150 million was for feasibility studies and an additional $100 million was for training programs. Procurement and personnel costs come out of addtional funds allocated for those purposes. These amounts compare with TDP's $20 million 1987 budget for all program activities as well as operating expenses.

The British Aid and Trade Provisions (ATP) earmarks aid funds to sweeten financing for contracts (including feasibility studies) in the developing world that British companies might otherwise lose. ATP represents about six percent of total British aid spending. Canada and Australia pay the cost of feasibility studies directly to the company performing the study. This approach differs from TDP's, which provides grant funding to the host government, which then selects the study contractor based on competition among qualified American firms.

## F. Conclusions

Despite differences in mission and operation, the five U.S. international financing programs share much common ground. All provide financing mainly to the developing world (and recently have also launched activities in Eastern Europe). All assist U.S. firms as a primary or secondary purpose and advance U.S. commercial interests abroad.

It bears emphasis that U.S. firms do have access to a diversity of government financing programs for their export, foreign investment, and other business-related activities. It is also true that, despite some overlap, each program addresses a specialized and different need-- Eximbank and CCC for export credit, OPIC for facilitation of foreign direct investment, and TDP for strategic project-planning. AID's concessional financing, addressing U.S. humanitarian concerns as well as foreign policy and national security interests, also supports a large volume of U.S. exports.

Despite the common ground, some observers perceive a lack of coherence among the U.S. programs. Particularly with regard to tied aid, they appear to believe that U.S. aid and business support functions tend to diverge instead of proceeding in an integrated and coordinated manner. Ernest Preeg of the Center for Strategic and International Studies states,

> A basic conceptual problem is the cleavage in thinking between those people concerned with commercial interests and those with economic development objectives, though in certain important areas, trade and aid interests are inextricably linked. Moreover, this cleavage passes from people to institutions, both in the mandates of executive branch agencies and in congressional committee jurisdictions. In short, the trade-aid relationship has been slipping between the cracks in terms of coherent policy response, to the detriment of U.S. export interests as well as of the most efficient delivery of foreign economic assistance.[2]

Eximbank in its 1989 analysis of tied aid emphasized as characteristic of tied aid programs abroad

> the institutional and political support provided by the commercial aspect of projects to the overall level of aid. For vulnerable trading nations a government/industry partnership is customary and assumed. The weight of

commercial factors in the decision making process is both instinctive and significant.[3]

AID's core mission of helping the developing countries is an integral part of U.S. foreign economic policy. Still, the question can legitimately be raised as to whether AID can do more at the margin to support U.S. trade and investment interests.

## II. LEVELS AND OTHER ASPECTS OF FINANCING

This chapter puts financing programs within the context of the overall resources received by developing countries and compares aid programs across selected aspects of financing. The analysis is based on data and concepts published by the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development. The DAC is a 19-member group comprising the major aid donors of North America, Europe, and the Pacific Rim that, inter alia, considers ways to improve aid quality and compiles aid data. The DAC database, despite some recognized anomalies,[6] contains the key statistical information on the financial flows of each of the DAC's 19 members under uniform definitions.

### A. Levels of Financing

In calendar year 1988, net financial resources disbursed to developing countries totalled over $100 billion, as shown in Table II-1.[7] Of the total, almost two-thirds consisted of official development finance[8]-- that is, finance from governments and multilateral agencies-- while one-third were private flows. Net export credit flows (both governmental and private) were low (reflecting repayments of outstanding export credits-- new commitments were, of course, higher). Flows from Eastern European and Arab, as well as DAC, countries are included in the total.

During the 1980s, official development finance became a much more significant component of net resource flows to developing countries. Private flows and export credit flows substantially outweighed official development finance in the early years of the decade, but during the mid-1980s fell to about half the level of official development flows. Since 1986, export credit and private flows appeared to have stabilized at low levels, an assessment confirmed by provisional 1989 data. When adjusted for price and exchange rates, an even stronger trend emerges showing that official development finance was relatively stable while net private and export credit flows dropped substantially.

The diminished private and export credit flows reflected multiple factors, including the debt repayment problems of the developing countries, a poor environment in the developing countries for undertaking new projects, and, in industrialized countries, new opportunities in the private financial markets. As a consequence, official development finance has become increasingly important as a source of finance for the trade and investment activities of business firms in developing countries.

Table II-1: Total Net Resource Flows to Developing Countries
(1984-88, $ billion, net disbursements)

| | Total Net Resource Flows | Official Development Finance | Export Credits | Private Flows |
|---|---|---|---|---|
| **In Current Dollars** | | | | |
| 1988 | $101.6 | $65.7 | $3.0 | $32.9 |
| 1987 | 96.6 | 61.7 | -0.7 | 35.6 |
| 1986 | 83.7 | 56.1 | -0.6 | 28.2 |
| 1985 | 83.8 | 49.0 | 4.0 | 30.8 |
| 1984 | 85.6 | 47.7 | 6.2 | 31.7 |
| 1983 | 95.1 | 42.4 | 4.6 | 48.1 |
| 1982 | 116.3 | 44.3 | 13.7 | 58.3 |
| 1981 | 137.7 | 45.6 | 17.6 | 74.5 |
| 1980 | 128.3 | 45.6 | 16.5 | 66.2 |
| **At 1987 Prices and Exchange Rates** | | | | |
| 1988 | $94.8 | $61.3 | $2.8 | $30.7 |
| 1987 | 96.6 | 62.0 | -1.0 | 35.6 |
| 1986 | 96.3 | 64.5 | -0.6 | 32.4 |
| 1985 | 119.4 | 69.8 | 5.7 | 43.9 |
| 1984 | 123.4 | 68.8 | 8.9 | 45.7 |
| 1983 | 134.1 | 59.8 | 6.5 | 67.8 |
| 1982 | 163.5 | 62.3 | 19.2 | 82.0 |
| 1981 | 188.9 | 62.6 | 24.1 | 102.2 |
| 1980 | 169.4 | 60.2 | 21.8 | 87.4 |

Source: DAC, 1989 Report, Table 13, page 217

## 1. Country Profiles

In 1987, the United States, France, Germany, Japan, and the United Kingdom together accounted for over half of all net resource flows. Another 11 percent was provided from the 14 other DAC members as a group, and a further 15 percent from multilateral institutions such as the World Bank, its sister regional banks, and United Nations agencies. The remainder came from Arab sources, the USSR and other CEMA countries, and non-DAC donors.

Of DAC net flows in 1987, nearly two-thirds consisted of foreign assistance, or "official development assistance" (ODA), as shown in Table II-2. ODA is a developmentally-motivated flow from an official source with a grant element of at least 25 percent, as defined by the DAC.[9] Three-quarters of DAC ODA disbursements was extended bilaterally to developing countries, and a quarter was channelled to multilateral agencies. The

rest of the DAC flows consisted of mainly private capital at market terms and net repayments on export credits.

The amount and composition of flows differed significantly among the major DAC members. Table II-2 also shows the relative emphases in 1987 of each of the above countries plus Canada and Italy, also large and active aid donors.

- Japan provided by far the largest volume of flows of all DAC members and was the only DAC donor with private flows making up a majority of its total flows. In fact, Japan supplied 80 percent of the private flows from all DAC countries.
- The United States was the second largest source of flows, with U.S. private flows lagging considerably behind Japan's.
- Both the United States and Japan had strongly negative export credit flows, offsetting the generally positive (though small) export credits from other major DAC donors.
- The United States, Japan, and France were the largest sources of ODA.

Table II-2: DAC Flows by Type and Country
(1987, in $ billion, net disbursements)

| | Total Net Resource Flows | ODA | Official Export Credits | Private Flows | All Other Flows |
|---|---|---|---|---|---|
| All DAC members | $65.7 | $41.4 | -$4.1 | $18.8 | $9.6 |
| United States | 13.2 | 8.9 | -2.9 | 4.4 | 2.7 |
| France | 8.7 | 6.5 | -- | -0.1 | 2.2 |
| Germany | 8.8 | 4.4 | -0.1 | 2.4 | 2.2 |
| Japan | 20.3 | 7.3 | -2.0 | 14.7 | 0.3 |
| United Kingdom | 3.4 | 1.9 | 0.2 | 1.1 | 0.3 |
| Canada | 2.8 | 1.9 | 0.2 | 0.2 | 0.6 |
| Italy | 2.0 | 2.6 | 0.5 | -1.9 | 0.8 |
| 12 Other DAC Members | 6.4 | 7.9 | 0.0 | -2.0 | 0.5 |

Source: DAC, 1989 Report, Table 50, page 264

A better guide to the potential scope that governments have for promoting national economic interests is found in the DAC data on bilateral commitments. Commitments data exclude the netting effects of DAC receipts from developing countries and also reflect more recent financing decisions. Bilateral data show the financial flows over which governments exercise relatively direct control, as distinct from resources passed through the multilateral institutions.

DAC bilateral ODA commitments from the seven largest DAC members rose appreciably during the period 1984-87, totalling $36 billion in 1987, as Table III-3 shows. The level of bilateral U.S. ODA was stagnant and declining in real terms. The other six largest DAC members all registered growth, with Japanese and Italian bilateral ODA showing particularly striking increases. The appreciation of the dollar underlies a major portion, but not all, of the increases in ODA abroad.[10] These divergent trends make support for trade and investment using ODA programs easier for several foreign governments, but more difficult for the United States.

Table II-3: Bilateral ODA Commitments
(1984-8, $ billion, current dollars)

| | 1988 | 1987 | 1986 | 1985 | 1984 |
|---|---|---|---|---|---|
| All DAC Countries | $ -- | $36.2 | $30.6 | $25.8 | $26.3 |
| United States | 7.9 | 7.4 | 8.7 | 9.2 | 8.1 |
| France | -- | 5.5 | 4.8 | 3.8 | 4.4 |
| Germany | 4.8 | 4.3 | 3.3 | 2.4 | 2.8 |
| Japan | 12.3 | 7.3 | 4.3 | 4.1 | 4.0 |
| United Kingdom | 1.7 | 1.4 | 1.1 | 0.7 | 1.0 |
| Canada | 1.9 | 1.6 | 1.2 | 1.2 | 1.6 |
| Italy | 3.0 | 3.1 | 2.3 | 1.2 | 0.9 |

Source: DAC, 1988 and 1989 Reports, Tables 51-56, pages 270ff

Prospects for individual donors' ODA growth in the medium-term future are summarized in the 1989 DAC Report as follows:[11]

- United States: "The level of appropriations for aid in recent years suggests that ODA disbursements may remain roughly stable in current prices in the near future."

- France: "As a share of GNP, French aid to independent countries stood at 0.50 percent.... Aid disbursements are expected to progress in the coming years since France is committed to raising ODA to independent countries to 0.7 percent of GNP as soon as possible."

- Germany: "...current financing prospects going beyond 1989 point to approximate stability in real terms in the volume of German aid."

- Japan: "1988 was the first year of the 1988-92 period during which Japan intends to raise [its] share of ODA in total DAC ODA to a level commensurate with the share of Japan in DAC GNP and to disburse more than $50 billion (its 4th medium-term target). Aid disbursements are expected to continue to increase given the determination of the Japanese authorities to reach their aid volume targets.... A revised recycling plan amounting to $65 billion, to supersede the current $30 billion one, was announced at the 1989 Western Economic Summit meeting."

- United Kingdom: "Future aid figures announced in... November 1988 indicate an increase in aid expenditure averaging 5.4 per cent per annum during the fiscal year period 1988/89-1991/92. This should allow some increase in the real value of British aid."

- Canada: "In April 1989,... the Government... temporarily suspended the ODA volume targets which it had accepted in 1986 (0.50 per cent of GNP until FY 1990/91 and 0.60 per cent in FY 1995/96).... Aid apropriations will rise by 0.02 per cent of GNP in FY 1990/91 and then by 0.005 per cent for the next three years to reach a figure between 0.46 and 0.47 percent of GNP in FY 1993/94."

- Italy: "ODA can be expected to expand in 1989, since the Italian authorities have indicated that their objective is to achieve an ODA/GNP ratio of 0.40 per cent."

In June 1990, the DAC released provisional 1989 DAC data indicating that, for the first time, the amount of U.S. net ODA disbursements fell to second place among DAC countries, after Japan's.[12] (It should be noted that the U.S. program consists almost entirely of grants, while the Japanese program relies heavily on loans.) Data on bilateral ODA commitments are not yet available. Furthermore, total net resource flows from Japan, driven by strong private flows, surpassed the corresponding U.S. flows in three of the four years since 1985.[13]

## B. SELECTED ASPECTS OF FINANCING

Individual countries' aid programs differ not only in their volume, but also in related aspects: aid-tying, sectoral distribution, and regional distribution.

### 1. Aid-Tying

Aid-tying is the linking of aid to imports by the recipient from one or more specified sources. Tied aid is defined by the DAC as aid funds required to be spent on imports mainly from the donor country or a few countries. Untied aid is available for procurement from essentially any source. Partially untied aid is available to finance imports from donor and substantially all developing countries. Industrialized country exporters in principle can access another donor's aid funds when such funds are fully untied, but have restricted access when the aid is tied or partially untied.

Aid-tying is not an ideal practice. In principle, aid that is untied is more efficient because the recipient is allowed to import from the most suitable and cost-effective suppliers. Experience also suggests that tied aid can lead to inefficient and wasteful procurement practices, sometimes with relatively low development impact. Biases can be created favoring aid-giving for those economic sectors absorbing capital equipment and for relatively more industrialized developing countries, to the detriment of others.

Nevertheless, tied aid has a clear and basic appeal to political constituencies. As one foreign government put it plainly,

> Tied aid reflects the legitimate concern of Canadians that their tax dollars should not end up subsidizing competitors in other industrialized countries. Canadians want to help developing countries, but they do not want to see Canadian assistance going to buy the products of wealthy countries that are Canada's rivals for overseas markets.[14]

The most frequently-cited rationale for aid-tying is that it builds political support from business groups for higher aid budgets. Also, a donor government may be under pressure to practice defensive or compensatory aid-tying if other governments are perceived to tie their aid to a greater extent. In support of these points, the DAC has noted that:

> Most donors feel obliged, largely with a view to securing public support, to tie a substantial part of their aid to

procurement from domestic suppliers. A broader move to untying would contribute to obtaining better value for aid money. Perhaps even more importantly, it would improve the climate for aid coordination and constructive donor co-operation.[15]

DAC data show that the United States, with 45 percent of its aid funds reported as untied, is in the middle range of the countries considered, as seen in Table II-4 below. Italy and the United Kingdom report significantly lower portions of untied aid, while Canada, France, Germany, and Japan report substantially higher portions.

Table II-4: Tying Status of ODA
(1987 Commitments, in percent)

| | Total[a] | Untied | Partly Untied | Tied |
|---|---|---|---|---|
| United States | 100% | 45.4 | 36.6 | 18.0 |
| France | 93% | 55.6 | 3.5 | 33.6 |
| Germany | 90% | 57.4 | -- | 33.0 |
| Japan | 100% | 72.1 | 16.6 | 11.3 |
| United Kingdom | 81% | 38.0 | 0.1 | 43.1 |
| Canada | 100% | 61.0 | 3.9 | 35.1 |
| Italy | 91% | 28.2 | -- | 62.4 |

[a] Certain rows do not add to 100 percent due to countries' ODA contributions to EEC institutions.

Source: DAC, 1989 Report, Table 5, page 209

Though formal aid-tying remains widespread, some governments have eased their requirements. In 1989, Canada reduced tying of important categories of its aid from 80 percent to as low as 50 percent, for the poorest developing countries. Japan has expanded the untied portion of its assistance. According to official Japanese statistics, the percentage of generally untied Japanese ODA loan commitments has risen from 53 percent to 81 percent during the period 1984-1989, while Japanese procurement under all ODA loans, on a principal contractor and presumed disbursment basis, has declined from 75 percent to 38 percent over the same period. (In 1989, bilateral loans accounted for 42 percent of all Japanese ODA.) Japan also has co-sponsored, together with the U.S. Government, information seminars in Orlando, Florida, and San Francisco, California, to

inform U.S. firms on the Japanese aid system. Japanese progress in this direction merits careful review and analysis.

The above aid-tying data do not tell the whole story, however. Many observers are skeptical, pointing out that formal aid-tying is supplemented by informal aid-tying mechanisms to enhance the export reflows from aid. One source, for example, indicates that "Procurement statistics show that 85 percent of partially untied aid results in procurement from Japan."[16]

Comprehensive, reliable information on informal aid-tying mechanisms is hard to come by. In a descriptive bibliography of over 150 sources, Catrinus Jepma of the University of Groningen in the Netherlands concludes that "solid systematic empirical research about [aid-tying practices and effects] is rather scanty."[17]

Jepma goes on to describe the broad range of informal aid-tying practices in the following terms:

> Clearly it is very hard to determine when and under what circumstances ODA is in effect tied, even if there is no formal agreement. Many examples of informal tying can be given in practice[. T]he selection of the programs and projects and/or the commodities and services financed have already been mentioned as an example. Another example is the potential impact of monetary unions between the donor and recipients as is the case, for example, with the Franc zone between France and its former colonies in Africa. Also, the aid procurement procedures can be a means to effectively tie the aid.... In addition, although hard to prove, the phenomenon of "silent understanding" or "mutual interests" often based on bilateral relations which go beyond the donor-recipient aid relationship alone, does play an important role in practice; this may be reinforced by the effect that the initiative in development projects is taken by experts who are formally or informally involved with the donor's aid policy. Finally, informal tying may result from tradition combined with convenience: entering the phase of "shopping around" is not even considered, because information costs are too high.[18]

Some examples of <u>de facto</u> tying practices have been described by various sources as follows:

- Donor-provided services for project design at the pre-construction stage and for project administration can critically influence the sourcing of later imports. In a recent report, the General Accounting Office (GAO) elaborated on the effects of such practices in the

following terms: "when Japanese companies design projects, procurement specifications naturally tend to be such that Japanese companies are best suited to fulfill them. Also, many of the interviewees believe the integrated nature of Japanese networks makes it quite likely that firms related to those performing planning or administrative tasks, through official affiliation or long-standing professional association, will be in a good position to submit bids by having advance information. This will have an effect on contract awards, even though international competitive bidding procedures are officially used to solicit bids." The GAO goes on to state that prime contractors on grant-funded projects must be Japanese and that, until recently, all members of consulting engineer teams performing a broad range of pre-construction studies had to be Japanese citizens; now, up to 25 percent of survey teams may be made up of non-Japanese nationals.[19] It should be noted that, besides Japan, Canada and the United States also have special financing facilities for pre-construction engineering services.

- Procurement theoretically open to developing countries may be meaningless when the items are beyond their technical ability to fulfill the order. The U.S. Foreign Commercial Service in Indonesia gives the following example: "Example no. 1 involves a Japanese LDC untied aid project, for a network of 8 fibre optic underseas trunk telecommunications cables linking a number of major cities and islands throughout the Indonesian archipelago. Contract no. 1, valued at U.S. dollars 61 million, was awarded to a Japanese consortium after none of the listed LDC's were able to submit complete bids (we do not know if any bids were submitted at all except for the Japanese consortium). The statistics show the contract value as part of Japan's LDC untied aid but in fact the money was spent on Japanese goods and services. The obvious question [is]what LDC manufactures trunk fibre optic telecommunications cable and is this a legitimate project for designation as LDC aid[?] U.S. firm AT&T joined in a Japanese consortium to compete for this project but was disqualified on the basis the US is not an LDC."[20]

- The donor-recipient consultation process may afford opportunities to tie aid informally. The GAO report notes that "lists of goods to be purchased with loan funds must be agreed upon in advance with Japanese authorities. Japanese policy concerning such loans directs procurement toward support for infrastructure projects, with associated trade benefits for Japan."[21]

- Under advance bidding practices, donors will agree to finance a project tendered for international competitive bidding if a firm from that country wins the bid-- a

practice that could tilt the contract award. In 1988, the DAC defined such advance bidding practices as tied aid for reporting purposes.

- Donor governments may provide tied aid to use within a stated time limit. Unobligated funds at the deadline expire-- creating an incentive for the developing country to shift business to the donor country in order to use up all available concessional funds. Similar practices are sometimes observed in large organizations at the end of a budget year.

- Procurement in developing countries under partially untied aid may in fact be sourced from developing country dealers in products exported from the donor country. Items such as trucks and construction equipment appear susceptible to such practices. Or, products of developing country origin may be manufactured by a subsidiary of a parent firm in the donor country.

Compilation of a comprehensive catalog of informal aid-tying practices is infeasible, given the diversity, creativity, and often covert nature of such practices. Further tightening DAC reporting rules can discourage the more blatant and systemic practices since some governments are reluctant to acknowledge high levels of aid-tying publicly.

A key aid-tying concept is "additionality." From a developing country perspective, a rational strategy is to maximize its total receipts of concessional funds. It follows that the developing country, when financing an upcoming project, would seek pledges of new aid and avoid reallocating aid that has already been promised. The Export-Import Bank documented three large export projects in Egypt, Botswana, and Jordan in which the United States proposed to reallocate previously-committed AID funding to support U.S. firms competing against foreign tied aid offers. The U.S. proposals were ineffective because the foreign offers represented additional aid inflows, while the AID reallocations did not.[22]

A second additionality strategy for developing countries is to use tied aid wherever possible to import commodities that would likely be sourced from the donor country anyway, like specialized spare parts and machinery. This strategy allows a developing country to conserve its hard currency to use for its own purposes.

Donor countries, however, can adopt counter-strategies to enhance export additionality. They achieve tighter tying by minimizing general-purpose cash transfers and balance of payments loans while concentrating financing on specific capital projects. This strategy was noted by Jepma, who states,

> Balance-of-payments support, for instance, offers much less scope for tying than project support.... Within the category of project support, again, the scope for effective tying differs widely. Especially capital project assistance seems to be a form of aid which can be tied relatively easily, whereas this is much less so for, e.g., basic human needs projects.[23]

Capital projects, which occur irregularly and are high in value, present targets of opportunity to donors for export expansion, market penetration, establishment of standards to induce follow-on exports, and support for industrial policy goals.[24] Testimony illustrating some of these effects was presented before a House Banking Subcommittee in May 1990.[25] The GAO contrasts U.S. and Japanese attitudes on capital projects in the following terms:

> Also relevant to the greater commercial orientation of Japan's program is the fact that Japan continues to emphasize improving recipient country economic infrastructure through projects and commodity loans. The United States, on the other hand, places greater emphasis on program assistance in support of economic restructuring and basic human needs.[26]

The above does not mean that commercial objectives invariably dominate aid-giving nor that donors lack genuine concern for developing countries; such is not the case. Many serious and successful efforts have been taken to improve aid quality and maximize the value of aid contributions, on Japan's part as well as others.

It is also true, however, that many foreign donors operate on the principles that capital projects are compatible with the needs of the developing countries and that the advancement of commercial exports does not necessarily conflict with the development process. In these instinctual beliefs, commercial and development objectives tend to merge and produce a unified and coherent response to the problems of economic development. The GAO, for example, refers to a "Japanese conviction that adequate infrastructure provides the basis for real private sector-led growth and, therefore, should be the focus of economic assistance efforts."[27] Such convictions-- which are shared by countries other than Japan-- can lead to a donor's foreign assistance program being structured in a way that results in significant trade reflows from aid.

## 2. Sector Distribution

Historically, AID has undergone three major policy phases. In the first, lasting through the 1960s, AID funds mainly financed capital projects. In the 1970s, a Basic Human Needs mandate gave priority to assistance directed toward the alleviation of poverty. During the debt crisis of the 1980s, AID began to emphasize cash grants and policy-based assistance to encourage developing countries to undertake economic reform measures.

As a consequence, the sectoral distribution of U.S. aid differs markedly from that of the six other countries under study. Nearly three-quarters of U.S. aid has now been reoriented toward humanitarian goals and budget support. Areas of emphasis include social and administrative infrastructure (education, health, potable water supply), food aid, and program assistance.

The six foreign countries spend a significantly smaller portion of their aid for these purposes, with Italy the lowest at 18 percent. Some exceptions are noteworthy: France and Germany provided relatively large shares of their aid for education, while 12 percent of Canadian aid was provided in food.

Most foreign countries devote a considerably larger share of their aid for purposes classified by the DAC as "Economic Infrastructure" and "Production." The United States directs less than 15 percent of its aid for transportation, communications, energy, agriculture, industry, mining, and construction. (Several of these sectors have been cited in other contexts as frequent targets of tied aid credits.) Italy and Japan spent over 60 percent of their aid in these areas; no country spent less than 25 percent of its aid in these sectors, other than the United States.

As discussed earlier under additionality, the sectoral distribution of aid can lead to implicit aid-tying. Projects requiring advanced or capital-intensive technologies may effectively exclude developing country participation, even if the aid is partially untied. Engineering, construction, and high technology industries in the donor country can benefit from aid regularly focused on economic and productive plant. Conversely, aid given outside the economic and production sectors is unlikely to capture major export contracts.

There can be no doubt that the objectives currently served by the U.S. aid program are important and support essential interests of the developing countries as well as our own. Many of these objectives are legislatively mandated. However, an imbalance between the United States and other donors is obvious and suggests that the United States is carrying a disproportionate burden in certain fields.

Table II-5: Bilateral Aid by Major Purposes
(1988 Commitments, in percent)

| | United States | France | Germany | Japan | United Kingdom | Canada | Italy |
|---|---|---|---|---|---|---|---|
| Total (percent) | 100% | 100% | 100% | 100% | 100% | 100% | 100% |
| Economic & Production | 14.3% | 27.7% | 46.0% | 60.7% | 41.8% | 30.2% | 61.2% |
| Transpt/Communicatns | 1.8 | .9.6 | 15.5 | 28.2 | 11.6 | 9.1 | 12.4 |
| Energy | 3.0 | 3.9 | 10.6 | 18.1 | 5.3 | 4.8 | 16.3 |
| Agriculture | 8.9 | 9.7 | 10.8 | 9.0 | 9.1 | 12.6 | 9.8 |
| Indus/Mining/Construc | 0.6 | 4.5 | 9.1 | 5.4 | 15.8 | 3.7 | 22.7 |
| Humanitarian/Budget | 72.3% | 49.4% | 39.7% | 29.6% | 33.8% | 36.4% | 18.1% |
| Social/Administratv | 23.4 | 45.1 | 32.1 | 14.0 | 18.1 | 15.6 | 11.9 |
| Food Aid | 16.4 | 0.7 | 2.9 | 1.3 | 1.3 | 12.1 | -- |
| Program Assistance | 32.5 | 3.6 | 4.7 | 14.3 | 14.4 | 8.7 | 6.2 |
| All Other Purposes | 13.4% | 22.8% | 14.2% | 9.7% | 24.3% | 33.4% | 20.7% |

Source: DAC, 1989 Report, Table 28, page 232

### 3. Geographic Distribution

Regionally, the distribution of ODA tends to reflect long-standing economic, historical, and geopolitical interests of donor countries. The United States focuses two-thirds of its aid on Middle Eastern/North African and Latin American/Caribbean countries, as shown in Table II-6. Japan provides half its ODA to Pacific Basin countries. France, the United Kingdom, and Italy provide half or more of their ODA to Sub-Saharan Africa, mainly to their former colonies, and the United Kingdom provides another quarter of its ODA to South Asia. By contrast, Germany and Canada distribute their ODA relatively evenly among regions. The top 10 ODA recipients of each of the seven major DAC donors are listed in Appendix B.

One effect of geographic ODA concentration is to strengthen ties to the principal donor country and inhibit third country exporters. In many cases it seems that purchasers simply do not even consider alternate suppliers. A major aid donor tends to foster a large market share for itself and freeze out other countries' suppliers, unless they are supported by "competing" ODA.

Conversely, historic geographic patterns constrain flexible use of ODA to penetrate non-traditional markets where other donors predominate. Traditional aid recipients exercise a powerful claim on available aid budgets. In the United States, existing aid programming, earmarking, and mortgaging practices limit deployment of resources outside AID's traditional regional focus.

Table II-6: Geographic Distribution of ODA
(1987-88 Gross Commitments, in percent)

| | United States | France | Germany | Japan | United Kingdom | Canada | Italy |
|---|---|---|---|---|---|---|---|
| Total, All Areas | 100% | 100% | 100% | 100% | 100% | 100% | 100% |
| Middle East/N. Africa | 43.4 | 11.1 | 30.4 | 8.5 | 6.2 | 7.3 | 12.4 |
| Latin America/Carib | 22.9 | 16.4 | 14.4 | 6.9 | 6.9 | 16.6 | 10.4 |
| South Asia | 11.6 | 4.5 | 15.8 | 22.3 | 27.6 | 24.9 | 5.0 |
| Other Asia/Oceania | 8.1 | 15.6 | 11.2 | 50.0 | 10.2 | 12.9 | 6.6 |
| Sub-Saharan Africa | 13.9 | 52.4 | 28.3 | 12.2 | 49.1 | 38.3 | 65.5 |

Source: DAC, 1989 Report, Table 8, page 212

The evidence does not support the view that, on a regional level, commercial motives are the driving force behind geographic aid patterns. Table II-7 shows the importance of various regions as markets for capital goods. While the Pacific Basin ranks highest as a major destination for capital goods exports, only one donor focuses its aid on that region.

Table II-7: Seven Countries' Capital Goods Exports to Developing Countries in 1987

| | $ billions | Percent |
|---|---|---|
| Total, All Areas | $113 | 100% |
| Middle East/North Africa (Non-OPEC) | $13 | 11 |
| Latin America/Caribbean | 30 | 26 |
| South Asia | 7 | 6 |
| Other Asia/Oceania | 55 | 49 |
| Sub-Saharan Africa | 8 | 7 |

Source: United Nations. Series D Database, SITC Revision 1, as compiled by the Department of Commerce.[28]

The Latin America/Caribbean area ranks as the second largest destination of capital goods exports. However, the region receives only about 10 percent of bilateral aid,[29] largely from the United States. A country comparison reveals that the largest and relatively prosperous Latin American markets for capital goods-- Argentina, Brazil, Colombia, Mexico, and Venezuela-- receive relatively small amounts of ODA. As seen in Appendix B, U.S. aid is concentrated on the smaller Central American markets. Sub-Saharan Africa, on the other hand, ranks relatively low as a regional importer of capital goods, but three donors concentrated their aid efforts there.

On an individual country level, however, some aid recipients have become known as "spoiled markets." These markets generally enjoy a relatively high credit standing and are strong importers of industrial plant as well as infrastructural equipment. They are seen to be blanketed with ODA tied to specific capital projects, such that concessional financing is essential or customary for capital goods sales.[30] Without support with aid funds, exporters find sales hard to make.

The same countries tend to be repeatedly named as spoiled markets. In 1988, Ernest Preeg identified Indonesia, Malaysia, Thailand, and Turkey as spoiled markets in the power, telecommunications, and transport sectors.[31] In 1989 testimony on behalf of the National Foreign Trade Association, Peter Rapuzzi, President of Chase Trade Inc., cited India, Indonesia, Thailand, China, and Algeria.[32] Another source indicates that China, Egypt, Indonesia and India, accounted in 1989 for 36 percent by value and 25 percent by number of tied aid notifications. In 1990, Eximbank President John Macomber referred in testimony to certain Asian and North African markets as spoiled.[33]

Spoiled markets are the subject of two official U.S. Government actions detailed in the next chapter. First, the United States is negotiating for tied aid restraints in problem sectors and spoiled markets. Second, a $500 million pool of funds established jointly by Eximbank and AID is targetted at four spoiled markets: Indonesia, Pakistan, the Philippines, and Thailand.

## C. Conclusions

The debt crisis of the developing countries during the 1980s sharply altered the amount and composition of financing they receive. While total flows declined substantially, sustained flows of official development finance partly offset steep drops in private flows and export credits, making official

development finance a more important source of support for developing countries' imports.

U.S. official development finance is still large in absolute volume, and the United States continues to be a major ODA donor. However, the relative position of the United States is slipping. Prospects are for other major countries' ODA to increase relative to U.S. ODA. These divergent trends make support for trade and investment using ODA programs easier for several foreign governments, but more difficult for the United States.

Several aspects of resource flows from developed countries also bear on U.S. trade, investment, and business-related interests:

- The United States and the six foreign countries under study all formally tie a sizable portion of their aid (with Japan the lowest), with another but unmeasurable portion subject to informal aid-tying practices. Several additionality strategies can be used to mitigate or enhance aid-tying by donors.

- The United States directs a large majority of its aid toward humanitarian and budget support purposes; other countries focus their aid on Economic and Production infrastructure.

- Several countries, including the United States, concentrate their aid on particular regions. An effect of regional patterns is to inhibit market penetration by third country exporters. On an individual country level, the emergence of spoiled markets has led to U.S. Government proposals to curb tied aid credits in such markets and undertake a $500 million pool of funds in such markets.

# III. SPECIAL TOPICS

This chapter provides a closer look at three special topics. Two of these, financing for the emerging democracies of Eastern Europe and U.S. pollution control exports to Eastern Europe, address a statutory requirement and the legislative history. The last section summarizes key aspects of the U.S. Government's policy approach toward tied aid financing.

## A. Financing for Eastern Europe

The mandate for this study directs that the use of foreign assistance and major financing programs in Eastern Europe be examined. The review indicates that in the current Eastern European context the financing programs have a quite different character from the tied aid financing discussed previously for developing countries.

The DAC database contains scant information on flows to Eastern Europe, and, therefore, this section uses other data sources covering the period since mid-1989: (1) unclassified U.S. Government lists of assistance to Hungary and Poland and (2) Polish-Hungarian Assistance Reports (PHARE), as compiled by the Department of State. These two data sources (included at Appendix C) cover the same transactions, but differ somewhat due to varying reporting and compilation dates, currency conversions, and other technical factors. Due to serious data deficiencies, Czechoslovakia and East Germany are excluded from this analysis.[34]

Between mid-1989 and mid-1990, 24 major industrialized countries-- also known as the "G-24"-- pledged more than $22 billion of financing (including debt relief) for Hungary and Poland, as shown in Table III-1.[35] Nearly three-quarters of the total is being provided by the United States and the six other major G-24 contributors plus the EC Commission. Overall, Germany is by far the largest contributor, followed by the EC Commission, Japan, and the United States in that order. Poland received the larger amount of support, over $17 billion, and contributions from the most participants. Hungary received pledges of nearly $5 billion, with the EC Commission and Japan as the chief contributors.

The $22 billion in resources are exclusive of funds from the World Bank Group and the new European Bank for Reconstruction and Development (EBRD). Between January and August 1990, the World Bank itself approved over $1 billion in loans to Poland

and over $300 million for Hungary. The International Finance Corporation and the Multilateral Investment Guarantee Agency, both World Bank affiliates, also are active in Poland and Hungary, although at lower levels. The new EBRD plans to lend up to $2.4 billion annually to Eastern European countries during its first five years of operation. U.S. firms are eligible for the export and investment opportunities opened up by World Bank and EBRD financing. The World Bank and EBRD support will be on commercial terms.

Table III-1: G-24 Assistance (Pledges) for Eastern Europe
(Mid-1989 to Mid-1990, $ billion)

| | Poland | Hungary |
|---|---|---|
| Total G-24 Members | $17.4 | $4.9 |
| Seven Largest G-24 Countries | $11.4 | $2.4 |
| United States | 1.6 | 0.2 |
| France | 1.0 | 0.4 |
| Germany | 6.3 | 0.6 |
| Japan | 1.4 | 0.9 |
| United Kingdom | 0.2 | 0.0 |
| Canada | * | * |
| Italy | 0.7 | 0.2 |
| EC Commission | $0.8 | $1.7 |
| All Other G-24 Members | $5.2 | $0.8 |

* = less than $100 million.

Source: U.S. Government unclassified compilation dated June 22, 1990

The financial resources for Poland and Hungary, though often called "assistance", differ in important respects from the official development assistance discussed in Chapter II. The recipients are industrialized, not developing, countries. The surge in financing to them springs from the events of 1989-90, not from the regular concerns of economic development. The DAC does not classify any Eastern European nation as a developing country. (This indirectly encourages DAC members to sustain their ODA flows to developing countries, since contributions to Eastern Europe cannot be counted as ODA.)

A second difference apparent in both the U.S. Government and PHARE data is that the "assistance" for Eastern Europe consists of pledges that so far are largely undisbursed. Not all the specific projects have been decided. Some pledges covering both countries have not yet been allocated between Poland and Hungary, and their availability ranges from one to several years. The flows described in Chapter II, on the other hand, are firm annual commitments or disbursements.

Further, the $22 billion of "assistance" to Poland and Hungary comprises a mix of resources on concessional terms (generally grants) as well as on market terms (such as export credits). Included in "asssistance" are Polish debt relief and a Stabilization Fund that have no counterpart in Chapter II. However, a major vehicle for tied aid in developing countries--tied concessional lending-- appears to be absent from the Eastern European scene, as detailed later.

Of the $22 billion total, about half is earmarked for debt relief ($9.7 billion) and a Foreign Exchange Stabilization Fund ($1 billion) for Poland, as shown in Table III-2. Comparable

Table III-2: Poland: Major Purposes of G-24 Pledges
(Mid-1989 to Mid-1990, $ billion)

| | Total | Debt Relief | Foreign Exchange Stab. Fund | All Other Purposes |
|---|---|---|---|---|
| Total G-24 Members | $17.4 | $9.7 | $1.0 | $6.6 |
| Seven Largest G-24 Countries | $11.4 | $6.1 | $0.9 | $4.3 |
| United States | 1.6 | 0.9 | 0.2 | 0.5 |
| France | 1.0 | 0.0 | 0.1 | 0.9 |
| Germany | 6.3 | 4.4 | 0.3 | 1.6 |
| Japan | 1.4 | 0.4 | 0.2 | 0.9 |
| United Kingdom | 0.2 | 0.0 | 0.1 | 0.1 |
| Canada | * | 0.0 | * | * |
| Italy | 0.7 | 0.4 | 0.1 | 0.2 |
| EC Commission | $0.8 | $0.0 | $0.0 | $0.8 |
| All Other G-24 Members | $5.2 | $3.6 | $0.1 | $1.5 |

* = less than $50 million.

Source: U.S. Government unclassified compilation dated June 22, 1990

debt relief was not made for Hungary. Thus, $11 billion remains that is available for other purposes in both Poland and Hungary. This amount is impressive by any measure and indicates abundant support for the export and investment activities of European and Japanese firms in Poland and Hungary.

The PHARE reports distribute the pledges among various end-uses such as projects, trade, and investment; food aid; technical and vocational training; and environmental improvement. Table III-3 shows that pledges are highly concentrated in projects, trade, and investment:

Table III-3: G-24 Assistance for Poland and Hungary Excluding Debt Relief and Stabilization Fund
(Mid 1989-mid 1990 pledges, $ billion)

| | Food Aid | Technical & Vocational Training | Projects/ Investment/ Trade | Environ-ment | Other |
|---|---|---|---|---|---|
| Total | $0.6 | $0.3 | $8.1 | $0.3 | $3.5 |

Source: G-24 PHARE Reports, as compiled by the State Department.

Inspection of individual pledges (excluding debt relief and the Stabilization Fund) corroborates the impression that financing for Poland and Hungary appears preponderantly related to the contributors' exports and direct investments. Pledges of "export credit guarantees" and "export credit insurance", in common nomenclature, denote government-backed financing tied to national exports. The individual pledges, copied for the seven largest contributors and the EC Commission in Tables III-4a and III-4b from Appendix C, total $7 billion.

Further evidence suggests an even larger proportion of pledges might be tied to procurement from the contributing countries. For example, an EC Information Memo listing nine projects worth more than $100 million (with over half the value for environmental protection programs) contains the statement that "Most of these operations will be put out for tender and open to all firms of the Community and the two recipient countries." See the EC Information Memo at Appendix C.

Thus, export and investment financing accounts for 80 percent of the resources contributed for Poland outside of debt relief and the Stabilization Fund and slightly over 50 percent for Hungary. (The percentage for Hungary rises to nearly 65 percent if two pledges from France and Italy for $550 million of unspecified credits turn out to be export credits, as seems plausible.) An undetermined portion of the remaining pledges

Table III-4a: Composition of Pledges for Poland
Excluding Debt Relief and Stabilization Fund
(Mid-1089 to Mid-1990, $ million)

| | | |
|---|---|---|
| UNITED STATES: Total | | $545 |
| Exports/Investment/Projects: Total | | 220 |
| Export credit guarantees | 100 | |
| Food aid | 120 | |
| All Other | | 325 |
| FRANCE: Total | | $936 |
| Exports/Investment/Projects: Total | | 921 |
| Short-term credits | 23 | |
| Export credit guarantees | 570 | |
| Investment guarantee scheme | 150 | |
| Export credits | 160 | |
| Investment fund | 18 | |
| All Other | | 15 |
| GERMANY: Total | | $1,645 |
| Exports/Investment/Projects: Total | | 1,600 |
| Export credit guarantees | 1,600 | |
| All Other | | 45 |
| JAPAN: Total | | $888 |
| Exports/Investment/Projects: Total | | 875 |
| Japan Eximbank loan and credits | 500 | |
| Trade insurance program | 350 | |
| Food aid | 25 | |
| All Other | | 13 |
| UNITED KINGDOM: Total | | $104 |
| Exports/Investment/Projects: Total | | 24 |
| Agricultural loan | 24 | |
| All Other | | 80 |
| CANADA: Total | | $14 |
| Exports/Investment/Projects: Total | | 10 |
| Food aid | 10 | |
| All Other | | 4 |
| ITALY: Total | | $611 |
| Exports/Investment/Projects: Total | | 528 |
| Export credit guarantees | 400 | |
| Joint venture financing | 20 | |
| Investment fund | 18 | |
| Food aid | 90 | |
| All Other | | 83 |
| EC COMMISSION: Total | | $820 |
| Exports/Investment/Projects: Total | | 651 |
| Project loans | 500 | |
| Food aid | 151 | |
| All Other | | 169 |

Table III-4b: Composition of Pledges for Hungary
Excluding Debt Relief and Stabilization Fund
(Mid-1089 to Mid-1990, $ million)

| | | |
|---|---|---|
| UNITED STATES: Total | | $190 |
| Exports/Investment/Projects: Total | | 100 |
| Export credit guarantees | 100 | |
| All Other | | 90 |
| FRANCE: Total | | $413 |
| Exports/Investment/Projects: Total | | 0 |
| All Other | | 413 |
| GERMANY: Total | | $570 |
| Exports/Investment/Projects: Total | | 550 |
| Export credit guarantees | 550 | |
| All Other | | 20 |
| JAPAN: Total | | $913 |
| Exports/Investment/Projects: Total | | 900 |
| Japan Eximbank loan and credits | 500 | |
| Trade insurance program | 400 | |
| All Other | | 13 |
| UNITED KINGDOM: Total | | $40 |
| Exports/Investment/Projects: Total | | 0 |
| All Other | | 40 |
| CANADA: Total | | $18 |
| Exports/Investment/Projects: Total | | 14 |
| Export credits | 14 | |
| All Other | | 4 |
| ITALY: Total | | $248 |
| Exports/Investment/Projects: Total | | 20 |
| Joint venture financing | 20 | |
| All Other | | 228 |
| EC COMMISSION: Total | | $1,695 |
| Exports/Investment/Projects: Total | | 500 |
| Project loans | 500 | |
| All Other | | 1,195 |

Source: U.S. Government unclassified compilation dated June 22, 1990

for training, the environment, and other purposes may also be tied to exports as well, as suggested by the EC Information Memo.

Export credit insurance and guarantees are extended on market-related (not concessional) interest rates and terms under international ground rules accepted by the G-24 (see Section C of this chapter). U.S. companies currently have access to financing from all five major U.S. international programs that is broadly comparable in financing terms, though not necessarily in volume. The largest U.S. Government transaction to date is $100 million of OPIC insurance for the GE investment in a Hungarian light bulb plant and a $200 million Eastern European Growth Fund OPIC has initiated to provide capital for new projects and expansion of existing private enterprise. Other applications for financing are in the processing pipeline. Program expansions are envisaged upon enactment of the pending SEED II legislation. Nevertheless, the level of foreign financing may call for augmented U.S. resources in the future if American firms need access to financing for their Eastern European business.

Regarding concessional finance, Table III-5 based on PHARE data shows that nearly a fifth of the commitments to Poland and Hungary from the major G-24 contributors comprised grants. West Germany gave the most grants by value, while the United

Table III-5: G-24 Grants to Poland and Hungary
(Mid 1989-mid 1990, $ billion)

| | Total Assistance | Grants Amount | Grants Percent | Loans |
|---|---|---|---|---|
| Total G-24 | $12,825 | $2,271 | 18% | $10,554 |
| From seven G-24 countries | $ 9,708 | $1,877 | 19% | $ 7,830 |
| United States | 1,023 | 709 | 69 | 314 |
| France | 874 | 17 | 2 | 857 |
| Germany | 4,343 | 827 | 19 | 3,516 |
| Japan | 2,112 | 54 | 3 | 2,058 |
| United Kingdom | 286 | 128 | 45 | 158 |
| Canada | 80 | 38 | 48 | 42 |
| Italy | 990 | 104 | 10 | 885 |
| From all other G-24 | $ 3,117 | $ 394 | 13% | $ 2,724 |

Sources: G-24 PHARE Reports, as compiled by the State Department

States made the greatest share of its contribution in grants (almost 70 percent of its total). Other significant contributors of grants in absolute value are the United Kingdom and Italy, while France, Japan, and Canada provided smaller amounts. The preponderance of grants appear related to debt relief or the Stabilization Fund, though an undetermined portion might be tied to procurement from the contributing country.

No pattern of tied concessional loans has yet surfaced, though the possibility of some untied concessional loans cannot be ruled out.[36] This contrasts with the situation in developing countries, where tied concessional loans are a principal source of the tied aid problem.

The United States has urged other governments to refrain from tying any concessional lending to Eastern Europe (except food aid). The matter of tied aid for Eastern Europe was addressed by the seven heads of government, including President Bush, at the 1990 Houston Economic Summit meeting. In the July 11 Summit communique, paragraph 32 states in part,

> It is also important to avoid introducing trade distortions in financial flows to the nations of Central and Eastern Europe.

The Summit communique, though not explicit, appears to imply a commitment not to allow Eastern Europe to become a new battleground for commercial advantage through tied aid lending.

In summary, the G-24 countries extended large amounts of "assistance" to Eastern Europe during the past year. The financing is, however, fundamentally different from the usual tied aid financing for developing countries in motivation and form. Debt rescheduling and the Stabilization Fund for Poland account for about half the G-24 financing for Eastern Europe. The other half seems to be mainly export and investment credits on market-related terms. U.S. agencies have made available a moderate amount of broadly comparable financing. For the time being, the G-24 countries appear to be exercising restraint on tied concessional lending.

## B. Environmental Protection and Eastern Europe

This section responds to the expressions of interest in the legislative history in environmental protection technology, services, and equipment for Czechoslovakia, Eastern Germany, Hungary, and Poland.

## 1. Current Environmental Needs

All Eastern European countries suffer from severe environmental degradation resulting from sustained and growing industrial pollution over the past 45 years. In certain areas such as Upper Silesia in Poland and Northern Bohemia in Czechoslovakia, degradation has been extreme. The extent of environmental damage varies from country to country, but some common causes can be readily identified.

The high sulphur content of brown coal, the main indigenous fossil fuel source for power generation, is believed to be largely responsible for acid rain devastation of forests and building decay in cities such as Krakow. Many industrial plants also use this coal for power and to operate smelting facilities and refine mineral ores. Air pollution generated from these plants transcends national boundaries and is a regional issue. While pollution control technology is known to many plant operators, industrial managers, and state enterprises, there has been little incentive to curb pollution at the risk of missing plan targets.

A reasonable alternative is to retrofit existing plants with flue gas desulphurization systems and scrubbers and to employ clean coal technology (atmospheric fluidized bed combustion) to ameliorate the adverse impact of the high sulphur content in brown coal. Another possibility is to help these plants adopt technology that reduces energy consumption. Nuclear power, which several Eastern European countries had adopted, also is unattractive due to cost and rising environmental opposition; the latter also has stymied development of hydro power.

Water pollution is a serious problem for all East European countries, depending on the level of existing treatment technology, the level of environmental science and application, and the availability of funds to acquire needed technology:

- In Czechoslovakia, an estimated 70 percent of rivers are heavily polluted. The main sources of pollution are mining wastes, sulphur dioxide, nitrates from fertilizer, liquid manure, and, more recently, oil; 40 percent of sewage is untreated.

- In Eastern Germany, some two-thirds of rivers and about a quarter of ground water are polluted. Sewage treatment is inadequate; organic waste is reportedly responsible for considerably more pollution (80 percent) than metals (3 percent). Parts of the Elbe River are unusable because of pollution. Offers of technology from West Germany were initially turned down because of terms attached to the offers. This undoubtedly has changed since the economic union in July.

- In Hungary, water pollution occurs inside the country and is imported via heavily polluted rivers entering from Romania and Czechoslovakia. An adequate sewage system exists for only 46 percent of the population, and 773 villages and towns have water believed to be unfit for consumption. Ground water pollution is also a problem--115,000 tons of nitrogen seep into ground water supplies annually.

- In Poland, 90 percent of surface and ground water is believed to be contaminated. Agricultural runoff (nonpoint source pollution), nitrates, raw sewage, and a general lack of adequate water and wastewater treatment systems will require massive investments in cleaning up the water supply.

While some experts believe legislation in East European countries is adequate to address pollution problems, enforcement has lagged way behind the acceleration in environmental damage. Proper enforcement coupled with introduction of appropriate and energy-conserving technology may help these countries gain some ground in reclaiming the environment.

Institutionally, Eastern European countries have more than adequate scientific and regulatory entities to implement legislation and introduce new regulations governing pollution abatement. There has been, until recently, lack of a sense of priority on the need to protect the environment. In addition, sophisticated technology has sometimes been blocked from export to Eastern Europe because of export controls on dual-purpose technology and hardware, such as microprocessors.

2. Opportunities for U.S. Firms

The United States has a vast reservoir of pollution abatement technology and equipment which it has developed over two decades of experience with domestic environmental problems. U.S. firms are technological leaders in the fields of hazardous waste, toxic substance disposal, incineration, resource recovery, and air, waste water, and water pollution.

With private sector know-how, the United States is in a position to lead in helping Eastern Europe out of its environmental problems. Other industrialized nations, however, are developing their own technological base and look on the Eastern European market as an outlet for sales and for achieving economies of scale and R&D.

All countries in Eastern Europe need to clean up the water supply. Joint ventures with American environmental management, construction, and design firms would accelerate these

countries' programs to improve their citizens' health and promote environmentally sustainable economic development.

Cleaning up the air also is critical to sustaining life. Employing either clean coal technology currently on the verge of commercialization in the United States or installing flue gas desulphurization systems, scrubbers, or other contaminant filtration technology will rather quickly provide measurable improvements in the countryside and cities and promote the rejuvenation of forests decimated by acid rain. The Japanese government recently announced plans to install air pollution control/abatement equipment in seven power generation facilities in Poland and a similar number in Hungary.

Finally, improving sewage treatment and hazardous wastes disposal and control is essential for removing heavy metals from drinking water supplies (both surface and subsurface). Lead, for example, poses an immediate threat to children and adults in most countries. Recomposition of building materials and improved water filtration systems will mitigate the long term effects lead has on the population.

3. Financing

Given the enormity of the environmental problems plaguing these countries, investments surpassing current foreign exchange indebtedness will be required. Polish Minister of the Environment Bronislaw Kaminski remarked last March that the total cost to clean up the environment in Poland by the year 2000 would probably exceed $25 billion in foreign exchange. In all of Eastern Europe, capital investment estimates for pollution control surpass $100 billion through the year 2010.

A principal obstacle to access to environmental technologies by Eastern Europe is the shortage of foreign exchange with which to purchase the needed equipment and services from abroad. As indicated previously, Japanese and European governments are moving forward with significant financial assistance to support their exports of environmental equipment. The fund is available in Eastern Europe and will emphasize projects that target pollution prevention and environmental control. The new European Bank for Reconstruction and Development will make some loans for environmental purposes when it opens next year.

The G-24 PHARE reports indicate that some $300 million is being made available for environmental protection, as is seen in Table III-3. Included in the $300 million is a $25 million U.S. grant to establish a regional environmental center in Budapest and a $15 million grant for pollution control in Krakow. OPIC is developing a $100 million fund that will provide start-up capital for U.S. sponsored business projects that establish sound environmental practices. The EC and the World Bank are also participating in these efforts. Additional

G-24 financing for environmental protection over and above the $300 million specifically allocated can be expected as pollution control technology is incorporated in new power plants, factories, and other facilities built with financing from the general export credit lines.

## C. U.S. Tied Aid Policy

This section reviews milestones in U.S. financing policy as it relates to aid and trade. The negotiating history is described first, followed by a recounting of U.S. countermeasures.[37] The overarching objective throughout has been to remove credit subsidy, including commercially-motivated aid, as an element of trade competition while maintaining a flow of resources on appropriate terms to needy developing countries.

### 1. International Negotiations

The subsidy issue rests on the recognition that the cost and terms of financing directly impact the effective price of a product or service. A low interest rate and/or prolonged period of repayment make capital projects cheaper and more viable. Financing costs, thus, are an integral part of total purchase costs.

In theory, competing exporters would be on an equal footing if financing were provided from market lenders without any subsidy amd capital were fully mobile internationally. Market mechanisms would equalize the real cost[38] of private financing across countries and currencies, and trade flows would reflect intrinsic product factors such as price and quality.

Governments may decide, however, to provide interest rates (or repayment periods) for their foreign trade and investment that are better than what market lenders would provide. Competing foreign firms rarely can counter such government interventions from their own resources. Such government-supported financing subsidies distort trade and investment and have been consistently opposed by the United States.

In 1974, after the first OPEC price shock, several major industrialized countries, including the United States, declared their intention to charge a minimum 7.5 percent interest rate in financing exports among themselves or to other wealthy nations. Recognizing the urgency of generating export earnings so as to pay for oil imports, the governments forged a consensus to limit counter-productive credit competition in order to realize the full return from their export efforts.

This first step was expanded and codified in an informal international "Consensus" on export credit in 1976 and recodified and further elaborated in 1978 as an "Arrangement on Guidelines for Officially Supported Export Credits", also informal in nature. The Arrangement's current members are 22 industrialized country governments in a group known as the "Participants" which is affiliated with the Organization for Economic Cooperation and Development. The Arrangement is continuously changing; by agreement among the Participants, the Arrangement is regularly revised to meet new developments and contingencies.[39] The Arrangement divides all country markets into three categories: relatively rich, intermediate, and relatively poor. For each category, the Arrangement sets forth guidelines for minimum interest rates and maximum repayment terms (see Table I-1). The poorer countries receive more favorable financing-- that is, lower mimimum interest rates and longer repayment terms.

In setting minimum interest rates in the 1970s, the Participants did not anticipate the volatile and sharply increasing market interest rates of the late 1970s and early 1980s. Very large credit subsidies emerged as significant negative gaps opened up between the interest rates charged by governments for export credits and the cost of borrowed government funds. During this period, exporters seeking competitive credit abandoned private lenders for government lenders and put strong pressures on government credit budgets.

The United States, exercising strong negotiating leadership over several years, succeeded in having the Arrangement fundamentally restructured in 1983. To reduce credit subsidies, interest rates were reset at market-related levels, and a mechanism was adopted to adjust rates automatically in step with current market conditions. Greater reliance was placed on guarantees and insurance to provide access to capital without subsidizing interest rates. The 1983 Arrangement also identified "Commercial Interest Reference Rates"-- proxies for a market rate in each Participant's currency-- that are currently in use and can serve as the basis for a future system of subsidy-free export credit.[40] Later, parallel financing agreements were negotiated on exports of large commercial aircraft and nuclear power plants to situate their financing terms at or near market rates. The 1983 Arrangement and subsequent improvements succeeded in wringing out most of the trade financing subsidies from the international trading system insofar as conventional export credit is concerned.

Aid initially was outside the purview of the Arrangement. Commercially-motivated tied aid credit practices first surfaced as a matter of concern in the late 1970s in the form of conventional export credits mixed with a small amount of concessional tied aid-- the so-called "mixed credits."

Inclusion of an even small aid component often enhanced the financing terms enough to influence the direction of contract awards, although the overall concessionality of the credit might convey only a minor degree of financial benefit (as measured by grant element) to the recipient developing country. In some cases, donors competed to provide aid for specific export sales, which is anomalous since given the abundance of different opportunities to promote development. The U.S. Government viewed foreign mixed credit practices as trade-distorting subsidies that put U.S. exporters at a competitive disadvantage.

Stung by export losses, a number of firms, labor groups, and trade associations voiced strong concern about mixed credits and tied aid. (Their recent views are detailed in Chapter IV.) The U.S. Government felt, in response, that the better approach was to negotiate mutual restraints on tied aid credits among the Participants in the context of the Arrangement. Launching U.S. subsidized financing to counter such subsidies would not provide a long-term solution to the problem and would waste resources.

While the restructuring of the Arrangement received the negotiators' priority attention during the early 1980s, some progress was made toward improving the mixed credit/tied aid situation. The basic approach was to increase the cost to governments of issuing mixed credits by raising the minimum concessional levels in hopes of choking off the number and volume of tied aid cases. Further, developing country recipients would benefit from financing that was more concessional.

After some interim steps, the Participants agreed in 1987 to raise the minimum concessionality level of tied aid credits to 35 percent (50 percent for the least developed countries). That is, a tied aid package would have to include a grant of at least 35 percent (or 50 percent) of the total or equivalent loan terms. Of comparable importance, the agreement forced certain countries to increase substantially the minimum aid component of their tied aid packages through a more rigorous computation of concessionality. The agreement came fully into effect in two stages ending in July 1988.

The post-agreement evidence suggests that just before the higher concessionality levels came into effect the volume of commercially-motivated tied aid increased by some 50 percent and then fell back 20 percent, but not to 1986-7 levels. At the beginning and end of the period, tied aid financed roughly the same share of developing country imports. A number of governments appear to have adjusted their aid allocations so as to meet the new minimum concessionality levels while continuing at previous or higher tied aid volumes. Some developing countries have, however, benefitted from the more generous tied aid financing terms.

In a parallel move in the DAC late in 1987, the United States advanced five proposals in an effort to harmonize development objectives with the removal of trade-distorting effects. These proposals included (1) a general untying of capital projects; (2) strengthened development criteria; (3) more flexible availability of technical support; (4) more responsive assistance for low-income countries; and (5) a coordinated transition for middle-income countries.[41]

The DAC's reaction to the U.S. proposals was mixed. The DAC has made progress on standards for project selection and appraisal. DAC governments also are coordinating more closely with each other and with multilateral institutions such as the World Bank in financing the procurement needs of the low-income developing countries. A general aid-untying effort, however, is strongly resisted by a number of governments because of perceptions that domestic support for aid programs would erode.

In 1989, the Administration's Economic Policy Council twice reviewed the tied aid issue and decided to press forward with negotiations among the Participants centered on restricting tied aid credits in spoiled markets and problem sectors (telecommunications, power, transport, and construction equipment).

The current negotiations are complex and involve other credit issues as well as tied aid credits. Pressure is being brought to bear, with calls for increased discipline and transparency from the 1989 and 1990 Economic Summits and the Organization for Economic Cooperation and Development at ministerial level. The target is to reach agreement on a substantial, balanced package of measures to increase discipline over tied aid and other export credit subsidies in mid-1991.

2. U.S. Countermeasures

The first U.S. steps to counter foreign tied aid credits took place in 1979, when Eximbank began matching selected foreign tied aid offers. Only $7 million in transactions received final Eximbank approval through 1981, however, after which the Administration concentrated its attention on revising the Arrangement guidelines for conventional export credits.

In 1981, AID created a Trade Finance Facility in Egypt, under which two transactions involving $6 million of AID resources and $35 million of Eximbank resources were financed in 1982. The AID facility was subject to several requirements, including a need for tendering procedures, concurrence in usage by the Egyptian Government, and reversion of any unused funds at the end of the fiscal year to Egypt's regular Commodity Import Program. These features, according to Eximbank, rendered the operation of the program "somewhat disappointing given the

numerous tied aid credit offers extended on Egyptian international tenders."

In 1983, Congress enacted the Trade and Development Enhancement Act which specifically authorized AID and Eximbank to engage in tied aid financing and called for their close cooperation. One joint transaction was consumated involving a $7 million AID grant and $20 million of Eximbank resources for a computer sale to India. Eximbank also supported some $15 million of exports under its own legislative authority. The lack of new resources prevented a more aggressive posture, however, particularly at AID with its extensively earmarked and mortgaged programs.

In 1985, following correspondence from Commerce Secretary Malcolm Baldrige to Treasury Secretary James Baker, the Administration asked Congress to establish a $300 million Eximbank "War Chest" of grant funds. Congress specified the War Chest should be used for transactions that would strengthen U.S. negotiating leverage, rather than generally to promote U.S. exports or offset foreign tied aid competition.

Eximbank immediately approved a number of concessional financing offers pending enactment of the War Chest. Authorizations continued over the next two years with a focus on transactions initiated by, or in the markets of, France and Japan which were felt to be impeding the negotations. Eximbank also began to initiate its own concessional financing offers, as distinct from the earlier purely defensive posture of matching offers initiated by others. Following the 1987 agreement, Eximbank used the War Chest to "police" the agreement. In total, from fiscal years 1979 through 1988, Eximbank provided concessional financing in 15 cases to support $451 million of U.S. exports,[42] while AID supported three cases involving $68 million of exports.

The Economic Policy Council, in its 1989 approval of the current negotiating approach, endorsed the use of the War Chest to strengthen the U.S. negotiating position, but decided at the time not to seek new resources for a separate tied aid credit program. The Administration indicated it would consider whether and how U.S. foreign assistance programs might provide greater support for infrastructure and capital projects.

In May 1990, AID and Eximbank created a joint $500 million pool of funds for capital goods financing in the spoiled markets of Indonesia, Pakistan, the Philippines, and Thailand. The strategy is to leverage already programmed AID resources by adding War Chest grants and long-term guarantees from Eximbank.

The pool consists of $200 million of grants, equally divided between Eximbank's War Chest and AID's ESF, plus $300 million of Eximbank-guaranteed private funds. No AID resources will be diverted between countries or within country programs, and no

Development Assistance funds will be used. AID has resources available in Indonesia, Pakistan, and the Philippines, but none for Thailand. Accordingly, Eximbank's War Chest is expected to supply the needed grant funds in this market. Future AID participation in such pools, therefore, may depend on the availability of ESF resources in the target countries.

The pool serves both development and trade objectives in that investment in priority projects in developing countries would be fostered through the financing of U.S. capital goods exports. Projects will be regarded as joint AID/Eximbank transactions from the outset and identified as such at an early stage. Further, AID and Eximbank would initiate financing packages from the joint pool, not simply react to foreign tied aid credit offers.

In summary, the U.S. policy since 1974 has been consistently to work toward eliminating credit subsidies related to trade. The result of the several agreements is a global system of conventional export financing that is closely related to market conditions and relatively subsidy-free. To achieve greater discipline over commercially-motivated tied aid remains a challenge. A prime reason is that the objective of eliminating subsidies is complicated by considerations of the developing countries' legitimate needs for capital and the differing approaches among donor nations over the appropriate purposes of aid financing.

## IV. PRIVATE SECTOR VIEWS

As legislatively required, the Commerce Department consulted with United States business organizations. The Department invited twelve such organizations to provide views on the subject matter of this study. The organizations contacted were:

The Air & Waste Management Association
The Bankers Association for Foreign Trade
The Coalition for Employment through Exports
The Hazardous Materials Control Research Institute
The Manufacturers' Alliance for Productivity and Innovation
The National Association of Manufacturers
The National Constructors Association
The National Federation of Independent Business
The National Foreign Trade Council
The National Solid Wastes Management Association
The U.S. Chamber of Commerce
The Water Pollution Control Federation

The Department also contacted Ambassador Ernest Preeg of the Center for Strategic and International Studies, who prepared several studies on tied aid that were cited in the legislative history for this study.

Several business organizations provided copies of testimony to Congress or letters that expressed their position. These views touched on a number of common points. First, emphasis was given to the need for a national policy integrating aid and trade objectives. Dr. Fruzsina Harsanyi, Vice President, Government Affairs, Combustion Engineering, Inc., testified on April 18, 1989, on behalf of the Coalition for Employment through Exports that

> What is needed... is a national policy response to the growing and absolute fact that foreign governments increasingly support their export industries through strategic use of assistance funds to penetrate and dominate markets. What we are most concerned with, is this trade and aid marriage. This single area is at the heart of our competitiveness problem.[43]

James H. Andrews, Vice President, Government Affairs, of the M.W. Kellogg Company, repeated this point in testimony on May

10, 1990, on behalf of the Coalition and the National Association of Manufacturers:

> The Tied Aid Credits practices of our foreign competitors remain the major concern as we continue to be disadvantaged by lack of a credible U.S. response to this problem.[44]

The U.S. business organizations claim serious adverse impacts from tied aid on their business. John H. Gentling, Senior Vice President-Industry Affairs, McDonnell Douglas Finance Corporation, testified in May 1990 on behalf of the National Foreign Trade Council as follows:

> Tied aid credits have had a substantial impact on many of our companies, affecting the volume of their exports to Third World markets, and in many cases, seriously eroding their productive capacity here at home. The use of tied aid credits is clearly associated with the efforts of a number of our trading partners to capture strategic export markets and establish competitive leadership in key industry sectors and priority industries.[45]

Along similar lines, James S. Cox, Treasurer-International of the Westinghouse Electric Corporation, provided the following testimony in 1989 on behalf of the National Association of Manufacturers:

> The dramatically different orientation of other foreign aid programs has not only kept the U.S. out of import development sectors in the Third World, but also has had a serious adverse impact on the U.S. trade deficit.[46]

U.S. business organizations expressed skepticism about the results of U.S. negotiating strategy. William T. Archey, Vice President, International, of the U.S. Chamber of Commerce said in 1989,

> The U.S. has made a major effort to end the practice through negotiation. Despite some successes, the negotiating effort has failed to produce results.[47]

Harsanyi expressed strong frustration and dissatisfaction with U.S. negotiating efforts in the following terms:

> Our experience shows that Federal government efforts to support trade are directed at attempting to negotiate multilateral disciplines for a free-market environment. These disciplines are ones in which only the U.S. seems to play by the rules.
>
> Though the U.S. has sought numerous negotiation forums and agreements to address the tied aid issue and lend discipline to the practice, all we have succeeded in accomplishing is to negotiate ourselves into placement on an uneven playing field where we never get the ball and must always run uphill.[48]

A number of organizations underscored the importance of maintaining exports of capital goods and capital projects. Archey provided data from the Chamber of Commerce's analysis on this point:

> At issue is the ability of the U.S. to improve its trade balance in manufactured goods.... Capital goods are the key to this effort, comprising approximately 45 percent of our manufactured goods exports.... it is precisely at the capital goods export market that foreign governments are concentrating their support, particularly with mixed credit programs.[49]

The Manufacturers' Alliance for Productivity and Innovation (MAPI), in a letter dated August 2, 1990, to the Department of Commerce, elaborated on the Chamber's statement:

> The loss of orders of capital equipment and other big ticket items in the current period has an adverse impact on future sales:
>
> -- The foreign customer is likely to return to the original supplier for future additions to capacity;
>
> -- The foreign supplier gains the sales of replacement parts which, over time, tend to at least equal the original sale and generally do not require government financing support; and
>
> -- In the case of highly sophisticated machinery and production facilities, the foreign supplier gains the reputation of having supplied the latest state-of-the-art technology and is sought out by other buyers.[50]

Other business organizations and representatives emphasized the developmental benefit of capital projects. Andrews testified

> We strongly believe the AID objectives are well served when AID resources are allocated to selected infrastructure projects such as telecommunications, power generation, water and sewer system installation. We see a win--win situation for the U.S.; AID's objectives are met with tangible results; and U.S. business gains credible market entry.[51]

Harsanyi makes an almost identical point:

> Capital Projects play a major role in many foreign assistance recipient country development strategies. Key sectors such as energy, telecommunications, power and transportation are critical to the economic growth of developing countries.[52]

Archey, referring to capital-intensive projects, contends

> The key factor here is to recognize that this type of long-term capital project is... a legitimate element of the development process.[53]

Several organizations recommend the creation at AID of a financing facility dedicated to the financing of capital projects in the interests both of U.S. trade and aid. In a Public Policy Summary of June 1989, the National Association of Manufacturers listed as one of three steps to strengthen the U.S. export finance system:

> Providing greater support for capital goods projects under our foreign aid program as a legitimate and necessary means of promoting both economic development and U.S. trade interests in countries that receive such assistance (Egypt, The Philippines and Pakistan, for example).[54]

Harsanyi states, in 1989:

> What is ultimately required, given the need to compete with resources equal to our competitors, is a dedicated tied aid program.[55]

In 1990, Gentling states,

> In order for the U.S. to have a reasonable impact on the negotiations, we would propose a War Chest of at least $200 million dollars [sic] for the coming fiscal year combined with A.I.D. resources in the same amount. These funds, along with Eximbank direct credits and commerical [sic] loans backed by Eximbank guarantees, would provide a credible pool of available competitive financing to challenge foreign tied aid offers in nearly every project/country specific situation. This combination of resources would give the U.S. a formidable position in future tied aid negotiations. The War Chest must be free-standing and can not rely on resources to support Eximbank's regular credit programs.[56]

On the latter point, MAPI voiced concern about possible erosion in resources for Eximbank's loan program, pointing out that while the mandate for this study indicates Congressional interest in tied aid

> We believe it is at least equally important to restore the credibility of the direct lending program of the Export-Import Bank, the single most important source of financing for U.S. capital goods exports.[57]

With regard to tied aid, MAPI sees merit in restructuring the current pattern of aid "extended to the five countries which receive... more than two-thirds of U.S. foreign aid." The $350 million thus freed up could be reallocated to Eastern Europe and increased funding for Eximbank's loan program and its War Chest.[58]

Preeg recommends a comprehensive three-point action program consisting of the following elements:

- A reconstituted and adequately funded (at $200 million annually) Eximbank War Chest. The War Chest would be combined with Eximbank loans and guarantees and operate defensively, to meet tie aid bids by other donors.
- A new capital projects program within AID, operating on a $500 million budget ($1 billion when combined with commercial funds at a 50 percent grant element level). Funds might come from ESF, rather than Basic Human Needs projects.
- A coordinated strategy for capital project assistance to be negotiated with other donor countries with agreed

development criteria for projects and a more clearly defined relationship between bilateral projects and financing by the multilateral development banks.[59]

The General Electric Company also commented to the Department of Commerce in a letter dated July 26, 1990. GE voiced strong concern about the adequacy and competitiveness of financing for U.S. firms doing business in Eastern Europe. (Interest in business opportunities in Eastern Europe and concern about possible competing concessional credits also was voiced by Gentling and Andrews in their testimony.[60]) A second point made in the GE letter was the need for increased funding for the Eximbank loan program.

## V. ENHANCING U.S. INTERNATIONAL ECONOMIC COMPETITIVENESS

Congress directed that this study explore ways and mechanisms to enhance U.S. international economic competitiveness through financing programs. One idea that has often been brought forth is the creation of a capital projects fund within AID to supplement Economic Support Funds (ESF) and Development Assistance (DA) resources. This capital projects fund has sometimes been called the "Third Window."

The Third Window would provide grants for U.S. exports for developmentally sound capital projects in developing countries. The Third Window must be free of regional and country earmarking in order that the recipient perceives that the aid resources are to be tied directly to new procurement. Its funds could be combined with Eximbank or private finance at market rates, multiplying total resources availability. The Third Window would be operated in accordance with the OECD Export Credit Arrangement and would not be subject to Basic Human Needs criteria.

Such a structure would enable AID to provide grants to developing countries for developmentally-sound capital projects, taking commercial benefits into account. To work effectively, the Third Window must operate flexibly and respond to the widespread opportunities in the various areas of the developing world. A pro of the approach, therefore, is its greater flexibility. Centrally-funded Third Window resources would augment bilateral and regional aid resources for some countries or finance projects in other developing countries that normally receive little or no DA or ESF funding, including middle-income countries. The Third Window could also support U.S. suppliers at the bidding stage as well as on upcoming projects in a longer time frame. Third Window resources would not be transferred to other uses and, if unobligated at the end of the fiscal year, would lapse.

The Third Window will provide assistance to exporters and increase the Administration's flexibility in resource allocation. A con is its cost. Under the budget agreement, both the Adminstration and the Congress agreed to a five-year cap on international discretionary spending. Resources for the Third Window must come from cuts to other programs, including possibly other foreign aid programs.

In the near-term, apart from a full-fledged Third Window, and in order to address exporters' concerns within budget constraints, the Administration has sought a creative approach to increase the economic impact of our assistance in the United

States while contributing to our overall development objectives. In May 1990, AID and Eximbank announced the creation of a $500 million facility to finance the export of U.S. goods and services for developmentally sound capital projects in Asian markets. AID's contribution to this facility will be $100 million with the remainder provided by Eximbank in the form of War Chest grants and loan guarantees. This facility is intended to finance capital projects in four Asian countries (Indonesia, Pakistan, the Philippines and Thailand) and four key sectors (construction, energy, transport, and telecommunications).

Bilateral agreements were concluded with Thailand and Indonesia to provide $125 million of mixed credits to each country for capital projects development. A Philippine mixed credit facility has also recently been created. Although Pakistan has been on a slower track, we hope to conclude bilateral agreements in November. Cooperation between AID and Eximbank has been excellent.

Another method to contribute to improving U.S. competitiveness overseas is to make full use of AID's "Buy American" policy. AID Administrator Roskens has ordered that a new system be devised for collecting AID expenditure data by the source and origin of the procurement. In addition, he has ordered that local procurement be restricted by limiting procurement waiver authority. The Administrator has further directed that AID be prepared to provide Congress and the American people with progress reports on the implementation of this "Buy American" policy. The first such report should be available in about five months.

In addition, the Administration has taken preemptive action to meet the needs of our exporters without spending additional resources. Most recently, the Administration has been successful in keeping tied aid out of Eastern Europe. Since the 1970s the Administration has successfully used the War Chest and AID funds in selected cases both defensively and offensively to discipline foreign tied aid practices, increased the concessionality level of tied aid, and improved notification procedures. The Administration will continue to discipline predatory tied aid practices through aggressive use of available funding and sustained negotiations.

In conclusion, any U.S. response to the problems of tied aid and export subsidization that would change foreign aid policy or increase capital project expenditures must avoid increasing the budget deficit or sacrificing important foreign policy objectives. The Administration welcomes a continuing dialogue with Congress on this important issue.

ENDNOTES

Introduction

[1] This study excludes defense financing and International Monetary Fund facilities.

Chapter I

[2] General Accounting Office. Economic assistance: Integration of Japanese aid and trade policies. Washington, D.C., May 1990, pages 8-9.

[3] For additional details on foreign export credits systems, see the following two publications from official agencies: Organization for Economic Cooperation and Development. The export credit financing systems in OECD member countries. Paris: 1990; and Export-Import Bank of the United States. Report to the U.S. Congress on export credit competition and the Export-Import Bank of the United States. Washington, D.C., various issues. The OECD publication is descriptive, while the Eximbank publication is more evaluative.

[4] Preeg, Ernest H. "Trade, Aid, and Capital Projects." in The Washington Quarterly, Winter 1989, volume 12, number 1, page 173.

[5] Export-Import Bank of the United States. Report to the U.S. Congress on Tied Aid Credit Practices. Washington, D.C.: 1989, pp. 38.

Chapter II

[6] For example, to ensure comparability among countries, the DAC reports financial flows on a calendar year basis and in dollars requiring exchange rate adjustments for non-U.S. flows.

[7] The statistical data used in this chapter are those for 1988 and earlier years, as published in Organization for Economic Cooperation and Development. Development Assistance Committee. 1989 report: Development co-operation in the 1990s. issued in Paris in December 1989 (cited hereafter as "DAC, 1989 Report"). On June 25, 1990, the DAC released limited provisional data for 1989 and revised the data for earlier years. The newer data are unavailable in sufficient breadth for detailed analysis, are subject to significant further revision in coming months, and do not change the basic findings of this study. For these reasons, and to facilitate

reference to a published source, this chapter uses the data in the 1989 DAC Report, except as expressly stated.

[8] Official Development Finance measures the inflow of developmentally-motivated resources to developing countries. It includes bilateral official development assistance (ODA), development lending by multilateral institutions, and other official flows for development purposes with too low concessionality to qualify as ODA, such as certain refinancing loans.

[9] While ODA, as defined by the DAC, is a widely-accepted definition of aid, many observers feel that the definition is not always respected. For example, the Administration's concerns about certain foreign tied aid, or "mixed credit", practices centers on the suspicion that some transactions reported as ODA are motivated primarily by commercial considerations.

[10] On a disbursement basis, ODA of the foreign donor governments generally grew at significantly lower rates when denominated in national currencies and, for most donors, was a stable percentage of GNP. Thus, ODA growth abroad in recent years has been largely a function of rising foreign donor GNPs, while U.S. ODA has declined as a percentage of GNP. See Table 19 (page 214) in World Bank. World Development Report 1990. Washington, D.C.: 1990.

[11] DAC, 1989 Report, pages 160-172.

[12] Organization for Economic Cooperation and Development. Press Release, June 25, 1990 (mimeo).

[13] See DAC, 1989 Report, Tables 55 and 57, pages 275 and 279.

[14] Government of Canada. Canadian International Development Assistance. Sharing Our Future. Ottawa, 1987, page 51.

[15] DAC, 1989 Report, page 141.

[16] Export-Import Bank, Tied aid credit practices, page 81.

[17] Jepma, Catrirus J. Tying of aid. Report prepared for the Organization for Economic Co-operation and Development, Development Assistance Committee, Paris, 1989 (mimeo), page 13.

[18] Ibid., pages 14-15.

[19] GAO, op. cit., pages 12-13.

[20] Telegram from U.S. Commercial Officer in Indonesia, August 3, 1990.

[21] GAO, op. cit., page 13.

[22] Eximbank, op. cit., pages 18-20

[23] Jepma, op. cit., page 28.

[24] A study of five European donors suggests that Germany uses its aid programs to advance the interests of its relatively uncompetitive railroad and ship-building sectors. Elsewhere, the engineering contracting sector is cited as the greatest beneficiary of the United Kingdom's mixed credit program with some 400 million pounds of business above its notional share. See Jepma, op. cit., pages 28 and 43. In another instance, the provision of 21 Westland helicopters to India, when the manufacturer was in financial difficulty, is cited as a case of tied aid benefitting the donor country more than the recipient.

[25] James H. Andrews, Statement before the Subcommittee on International Development, Finance, Trade and Monetary Policy, Committee on Banking, Financing and Urban Affairs, U.S. House of Representatives, May 10, 1990 (mimeo), pages 3-4.

[26] GAO, op. cit., page 15.

[27] Ibid., page 7.

[28] See data in Eximbank, Tied aid credit practices, pages 239-246; also, DAC, 1989 Report, Table 33.

[29] Table II-7 shows exports from the seven countries under study to developing countries in SITC groupings 71-73, used as a proxy for capital goods. The DAC regional definition is used for the UN data, except for a few negligible omissions. Data from 1987 were used as 1988 reporting is incomplete.

[30] Telegram from Indonesia.

[31] Preeg, Ernest H., Statement before the Subcommittee on International Finance, Trade and Monetary Policy, Committee on Banking, Financing and Urban Affairs, U.S. House of Representatives, May 14, 1988 (mimeo), page 6.

[32] Rapuzzi, Peter, Statement before the Subcommittee on International Economic Policy and Trade, Committee on Foreign Affairs, U.S. House of Representatives, April 18, 1989 (mimeo), page 6.

[33] Macomber, John, Statement before the Subcommittee on International Development, Finance, Trade and Monetary Policy, Committee on Banking, Financing and Urban Affairs, U.S. House of Representatives, May 10, 1990 (mimeo), page 4.

Chapter III

[34] A review of unclassified data sources has uncovered only fragmentary and anecdotal accounts of financing transactions for Czechoslovakia and East Germany. In the absence of reliable data, these two countries were excluded from the study. The recent date of political events in Czechoslovakia probably accounts for the paucity of transactions reported; however, G-24 PHARE data-collection may start shortly. For East Germany, few countries other than West Germany appear to have offered credits in light of the union between East and West Germany that is expected before 1991.

[35] The G-24 also includes the European Economic Communities as a collective entity, providing funds contributed by the 12 EEC member states. Counting the EEC, there actually are 25 members of the G-24.

[36] Only one tied concessional loan has been verified in Eastern Europe, for a telecommunications contract. The CIA compilation also indicates some ambiguous "soft loans" from Italy and Japan to Poland and Hungary.

[37] For details on the negotiations and U.S. countermeasures, see Eximbank, Tied aid credit practices, pp. 17-25, Preeg, "Trade, Aid, and Capital Projects", pages 179-181, and U.S. Treasury. National Advisory Council on International Monetary and Financial Policies. Annual Reports. Washington, D.C., 1975 et seq.

[38] While long-term interest rates differ among countries and currencies in nominal terms, rate differentials in reality reflect sophisticated borrowers' expectations, inter alia, of relative rates of currency appreciation or depreciation and underlying factors such as differences in inflation rates and trade trends. In principle, borrowers should be indifferent whether to borrow long-term in yen at 7 percent interest or sterling at 12 percent, so long as interest differentials are market-determined and reflect market participants' judgments concerning relative future rates of inflation.

[39] The Arrangement as revised to November 1989 is reproduced in Organization for Economic Cooperation and Development, Export credit financing systems, pp. 263ff.

[40] During this phase, agreement on a Subsidies Code also was reached in the Tokyo Round of Trade Negotiations. Item (k) of the Illustrative List of Prohibited Trade Subsidies restricts Code signatories from undercutting the Arrangement or providing export credit at an interest rate below the cost of borrowing to Governments.

[41] See Preeg, Ernest H., 1988 Statement, pages 8-13, for a detailed description of these proposals and their acceptance.

[42] Eximbank, Tied aid credit practices, pages 29-33.

Chapter IV

[43] Fruzina Harsanyi, Statement before the Subcommittee on International Economic Policy and Trade, Foreign Affairs Committee, U.S. House of Representatives, April 18, 1989 (mimeo), page 5. See also Statements of William T. Archey, page 3, and James S. Cox, page 7, at the same hearings.

[44] Andrews, Statement, page 1.

[45] John H. Gentling, Statement before the Subcommittee on International Development, Finance, Trade and Monetary Policy, Committee on Banking, Financing and Urban Affairs, U.S. House of Representatives, May 10, 1990 (mimeo), page 1. See also Andrews, Statement, pages 2-3.

[46] James S. Cox, Statement before the Subcommittee on International Economic Policy and Trade, Foreign Affairs Committee, U.S. House of Representatives, April 18, 1989 (mimeo), pages 1-2.

[47] Archey, William T., Statement before the Subcommittee on International Economic Policy and Trade, Foreign Affairs Committee, U.S. House of Representatives, April 18, 1989 (mimeo), page 5. See also Harsanyi, Statement, pages 3-7, Cox, Statement, pages 5-6, and Gentling, Statement, page 3.

[48] Harsanyi, Statement, pages 5-6.

[49] Archey, Statement, page 3. See also Cox, Statement, pages 2-3.

[50] Manufacturers Alliance for Productivity and Innovation, enclosure to letter of August 2, 1990, to the Department of Commerce, page 2.

[51] Andrews, Statement, page 5. See also Harsanyi, Statement, pages 10-12, and Archey, Statement, page 7.

[52] Harsanyi, Statement, page 12.

[53] Archey, Statement, page 8.

[54] National Association of Manufacturers. Export financing, manufactured exports and the trade deficit. (Issue Brief: A Public Policy Summary.) Washington, D.C., June 1989, page 2.

[55] Harsanyi, Statement, page 12. See also Archey, Statement, pages 7-8.

[56] Gentlig, Statement, page 4.

[57] MAPI, Letter, page 1.

[58] Ibid, enclosure, pages 6-7.

[59] Preeg, Ernest H. The tied aid credit issue: U.S. export competitiveness in developing countries. Washington, D.C.: Center for Strategic and International Studies, 1989, pages 24-29.

[60] Gentling, Statement, pages 7-8, and Andrews, Statement, page 4.

## Appendix B

[61] The data presented in Appendix B are adapted from Table 40 of the 1989 DAC Report. Table 40 shows the percentage of total ODA for multilateral ODA, unallocated ODA, and bilateral ODA for the top 25 ODA recipients. Total bilateral ODA was derived as the residual after subtracting multilateral and unallocated ODA and then used as the base for computing each recipient's percentage of bilateral ODA.

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# APPENDIX A

## TEXT OF LEGISLATION

Sec. 321. COMMERCIAL ASPECTS OF UNITED STATES FOREIGN ASSISTANCE.-- (a) The Secretary of Commerce, after consulting with the Administrator of the Agency for International Development, the Secretary of Agriculture, the Secretary of Energy, the Secretary of Treasury, the Secretary of State, and other appropriate agencies of the United States Government, and United States business organizations, shall conduct a study which examines and explores the foreign assistance programs currently engaged in by the United States Government and major international financing programs of the United States Government, through the Agency for International Development and other appropriate departments and agencies of the United States Government and explores mechanisms and ways by which the international economic competitiveness of the United States may be enhanced through such programs. In undertaking this study, the Secretary shall--

(1) examine the foreign assistance and major financing programs of Japan, West Germany, France, the United Kingdom, and such other international aid donors as the Secretary may designate, for the purpose of determining what mechanisms are in use to tie foreign assistance to, and advance the industrial and commercial interests of, the donor nations, in particular the programs currently being engaged in and planned by such countries in the Eastern European countries of East Germany, Poland, Czechoslovakia, and Hungary; and

(2) determine, as far as possible, for each of fiscal years 1989 and 1990, and requested for fiscal year 1991, the dollar amounts and percentages of current United States programs which support United States business investment, exports, or other business-related activities, and shall compare that assessment with a similar assessment made for each of the other international aid donors examined by this study, on a region-by-region basis, with particular attention paid to the comparable efforts in the Eastern European countries referred to in paragraph (1).

(b) Not later than September 20, 1990, the Secretary of Commerce shall prepare and transmit to the Committees on Foreign Relations and Appropriations of the Senate and the Committees on Foreign Affairs and Appropriations of the House of Representatives, a report setting forth the findings of the study conducted under subsection (a).

(Public Law 101-302, 104 STAT 213)

# APPENDIX B

## Major Recipients of Aid

(Percentage of Bilateral ODA[61], gross disbursements, 1987-88)

| United States | | France | | Germany | |
|---|---|---|---|---|---|
| Top 10 | 64.2% | Top 10 | 56.2% | Top 10 | 41.3% |
| Israel | 21.0 | Reunion | 11.6 | Turkey | 8.5 |
| Egypt | 16.4 | Martinique | 8.8 | India | 7.0 |
| El Salvador | 5.8 | Fr. Polynesia | 6.8 | Egypt | 5.6 |
| Pakistan | 4.7 | New Caledonia | 6.0 | Indonesia | 4.7 |
| Philippines | 3.1 | Guadeloupe | 4.6 | Israel | 3.2 |
| India | 3.0 | Morocco | 4.0 | Brazil | 3.2 |
| Pacific Is. | 2.8 | Cote d'Ivoire | 4.0 | Pakistan | 3.0 |
| Honduras | 2.6 | Senegal | 4.0 | China | 2.4 |
| Guatamala | 2.4 | Guiana | 4.0 | Tanzania | 1.8 |
| Costa Rica | 2.3 | Madagascar | 2.3 | Bangladesh | 1.8 |

| Japan | | United Kingdom | | Canada | |
|---|---|---|---|---|---|
| Top 10 | 66.2% | Top 10 | 53.2% | Top 10 | 45.0% |
| Indonesia | 17.0 | India | 13.2 | Bangladesh | 10.7 |
| China | 9.5 | Bangladesh | 6.2 | Pakistan | 5.8 |
| Philippines | 8.2 | Kenya | 6.0 | India | 5.1 |
| Thailand | 6.2 | Tanzania | 4.6 | Indonesia | 4.3 |
| Bangladesh | 5.6 | Malawi | 4.4 | Tanzania | 3.9 |
| India | 5.2 | Mozambique | 4.2 | Jamaica | 3.4 |
| Pakistan | 3.9 | Ghana | 4.0 | China | 3.4 |
| Malaysia | 3.7 | Sudan | 3.8 | Kenya | 3.0 |
| Burma | 3.6 | Pakistan | 3.5 | Zambia | 2.8 |
| Korea | 3.4 | Zambia | 3.3 | Mozambique | 2.6 |

| Italy | |
|---|---|
| Top 10 | 61.7% |
| Mozambique | 11.2 |
| Somalia | 11.1 |
| Ethiopia | 9.4 |
| Tanzania | 7.1 |
| China | 5.6 |
| Tunisia | 4.3 |
| Sudan | 4.0 |
| Egypt | 4.0 |
| India | 2.6 |
| Senegal | 2.4 |

From: DAC, 1989 Report, Table 40, page 247ff

# APPENDIX C

# G-24 ASSISTANCE FOR HUNGARY SINCE PARIS SUMMIT

| | Debt Rescheduling | New Credit | Private Sector/Environment Technical Assistance Grants |
|---|---|---|---|
| EC COMMISSION | | -$500 million project loans from European Investment Bank (H)<br>-$1 billion balance of payments loan | -$165 million technical assistance grants (H<br>-$30 million environmental aid |
| WEST GERMANY | | -$550 million export credit guarantees | -$2 million management training<br>-$1.5 million grant for political foundations (H)<br>-$16 million for social development (H |
| UNITED KINGDOM | | | -$40 million political foundations grants |
| FRANCE | | -$400 million loan guarantee | -$8 million small business fund<br>-$5 million for cultural, scientific and technical cooperation |
| DENMARK | | -$21 million investment fund (H)<br>-$72 million investment guarantees (H) | |
| NETHERLANDS | | -$3.9 million general credits (H) | -$10.5 million technical training (H) |
| BELGIUM | | -$83 million export guarantees | -$1.8 million technical assistance (H |
| IRELAND | | | -$0.1 million management training<br>-$0.5 million (H) |
| SWITZERLAND | | | -$28 million environment, education, scientific<br>Investment guarantees being considered<br>-Management training |
| CANADA | | -$14 million export credits | -$4 million technical assistance grant (H |
| JAPAN | | -$500 million EXIM loans and credits<br>-$400 million trade insurance program | -$12.5 million technical assistance (H |

(H) Denotes half of the total value of an assistance program to be shared by Poland and Hungary but not yet alloted to each country

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| | Debt Rescheduling/Forgiveness | New Credit | Food Aid | Private Sector/Environment/Technical Assistance Grants |
|---|---|---|---|---|
| NETHERLANDS | | -$3.9 million in general credits (H) | | -$1.5 million in technical training<br>-$5 million medical aid<br>-$42 million environmental aid |
| LUXEMBOURG | | | | -$0.6 million unspecified projects |
| BELGIUM | -$55 million Paris Club rescheduling | -$83 million exports guarantees | | -$1.8 million technical assistance (H) |
| PORTUGAL | | -$2.5 million to Foreign Exchange Stabilization Fund loan | | |
| SPAIN | | -$14 million to Foreign Exchange Stabilization Fund loan<br>-$50 million export guarantees | | -$0.6 million vocational training (H) |
| IRELAND | | | | -$0.5 million (H) |
| SWITZERLAND | | -$196 million credits<br>-$30 million loan for Foreign Exchange Stabilization Fund<br>-$21 million agricultural loans | -$3 million | -$28 million environment, educatio scientific (H) |
| AUSTRIA | | -$205 million East-West investment fund (H)<br>-$80 million Vienna export credits | -$2.9 million | -$20 million Foreign Exchange Stabilization Fund<br>-$10.5 million training grant (H) |
| NORWAY | | -$21 million investment and export guarantees | -$1 million | -$5 million to Foreign Exchange Stabilization Fund<br>-$3 million environment and training gran |
| SWEDEN | | | | -$10.5 million contribution to Foreign Exchange Stabilization Fund<br>-$46 million environment training |

(H) Denotes half of the total value of an assistance program to be shared by Poland and Hungary but not yet alloted to each country.

| | Debt Rescheduling/Forgiveness | New Credit | Food Aid | Private Sector/Environment/Technical Assistance Grants |
|---|---|---|---|---|
| FINLAND | | | -$7.8 million | -$23 million environment<br>-$0.25 million training grant<br>-$5 million Stabilization Fund |
| ICELAND | | -$0.3 million Foreign Exchange Stabilization Fund | -$0.3 million | |
| CANADA | | -$17 million credit guarantees being considered | -$10 million | -$25 million Foreign Exchange Stabilization Fund (reimbursable grant)<br>-$4 million technical assistance grant (H) |
| JAPAN | -$400 million Paris Club rescheduling | -$150 million soft loans, contribution to Foreign Exchange Stabilization Fund<br>-$500 million EXIM loan and credits<br>-$350 million Trade Insurance Program | -$25 million | -$12.5 million technical assistance (H |
| AUSTRALIA | | -$0.75 million Foreign Exchange Stabilization Fund | -$4 million | |
| TURKEY | | -$100 million export credit guarantees | -$1 million | -$0.5 million for economic restructuring (H)<br>-$1.5 million Foreign Exchange Stabilization Fund grant |
| NEW ZEALAND | | -$30 million export credit guarantees (H) | | -$0.15 million technical assistance (H) |
| NORDIC COUNTRIES | | -$25 million for financing environmental projects (H) | | -$0.22 million environment and agricultural training |
| UNITED STATES | -$899 million Paris Club rescheduling | -$100 million export credit guarantees (H) | -$120 million | -$325 million<br>-$200 million Foreign Exchange Stabilization Fund |

(H) Denotes half of the total value of an assistance program to be shared by Poland and Hungary but not yet alloted to each country.

| | Debt Rescheduling/Forgiveness | New Credit | Food Aid | Private Sector/Environment/Technical Assistance Grants |
|---|---|---|---|---|
| TOTAL | -$9 billion of 1986-88 obligations in Paris Club**<br>-$700 million forgiven | -$6.0 billion | -$462 million | -$1.2 billion |

** Refers to Polish debt service payments covered by the December 1987 Paris Club framework, for which bilateral agreements have all been reached since April 1989.

# G-24 ASSISTANCE FOR POLAND SINCE PARIS SUMMIT

| | Debt Rescheduling/Forgiveness | New Credit | Food Aid | Private Sector/Environment/Technical Assistance Grants |
|---|---|---|---|---|
| EC COMMISSION | | -$500 million project loans from European Investment Bank (H) | -$151 million | -$165 million grant for management training, environment and agriculture (H)<br>-$2.85 million medical aid<br>-$1.2 million pharmaceuticals, food |
| WEST GERMANY | -$700 million 1970s loan partially forgiven<br>-$3.7 billion Paris Club rescheduling | -$2 million bank credit for craftwork<br>-$1.6 billion export credit guarantees<br>-$250 million line of credit for Foreign Exchange Stabilization Fund | | -$5 million for private agriculture and management training<br>-$1.5 million grant for political foundations (H)<br>-$20 million for EC "Action Plan"<br>-$16 million for social development (H |
| FRANCE | | -$23 million short-term credits<br>-$570 million export credit guarantees<br>-$150 million investment guarantee scheme<br>-$100 million to Foreign Exchange Stabilization Fund loan<br>-$160 million export credits<br>-$18 million investment fund | | -$15 million technical assistance grant |
| ITALY | -$400 million Paris Club rescheduling | -$400 million export credits guarantees<br>-$75 million soft loans<br>-$100 million Foreign Exchange Stabilization Fund<br>-$20 million joint venture financing (H) | -$90 million | -$0.75 million management training (H)<br>-$17.5 million investment fund (H)<br>-$7.5 million pharmaceuticals |
| UNITED KINGDOM | | -$24 million agricultural loan | | -$80 million management training<br>-$100 million grant for Foreign Exchange Stabilization Fund |
| DENMARK | | -$21 million investment fund (H)<br>-$72 million investment guarantees (H) | -$40 million | -$5 million agriculture and environment grant |

(H) Denotes half of the total value of an assistance program to be shared by Poland and Hungary but not yet alloted to each country

Information as of
22 June 1990

| | Debt Rescheduling | New Credit | Private Sector/Environment/Technical Assistance Grants |
|---|---|---|---|
| AUSTRIA | | -$205 million East-West investment fund (H) | -$0.7 million education program (H) |
| TURKEY | | -$100 million export credit guarantees (H) | -$0.5 million for economic restructuring (H |
| ITALY | | -$150 million unspecified credits<br>-$60 million soft loans<br>-$20 million joint venture financing (H) | -$0.75 million management training (H)<br>-$17.5 million investment fund (H) |
| SWEDEN | | -$153 million export guarantees | |
| FINLAND | | -$100 million for reconstruction projects | -$0.25 million training grant (H) |
| NEW ZEALAND | | -$30 million export credit guarantees (H) | -$0.15 million technical assistance (H) |
| SPAIN | | | -$0.6 million vocational training (H) |
| NORDIC COUNTRIES | | -$25 million for financing environment projects (H) | |
| UNITED STATES | | -$100 million export credit guarantees (H) | $90 million |
| TOTAL | | -$4.5 billion | -$435 million |

(H) Denotes half of the total value of an assistance program to be shared by Poland and Hungary but not yet alloted to each country

G-24 Assistance to Poland and Hungary -- pledges as of 5/21/90
Millions of Dollars

| | Food Aid | Tech & Vocation | Project/Trade Inv Credits | Envir | Other | Stabil Fund | Total | % of Total |
|---|---|---|---|---|---|---|---|---|
| Australia | 4.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.8 | 5.0 | 0.04% |
| Austria | 4.2 | 20.2 | 82.8 | 0.0 | 0.0 | 20.0 | 127.2 | 0.92% |
| Belgium | 0.0 | 0.0 | 166.7 | 0.0 | 3.6 | 0.0 | 170.3 | 1.23% |
| Canada | 11.0 | 9.2 | 18.5 | 0.0 | 14.0 | 25.0 | 77.8 | 0.56% |
| Denmark | 0.0 | 7.2 | 195.0 | 75.0 | 0.0 | 7.7 | 284.9 | 2.05% |
| FRG | 9.6 | 3.8 | 2,005.8 | 0.0 | 2,051.6 (a) | 250.0 | 4,320.9 | 31.14% |
| Finland | 8.4 | 0.5 | 0.0 | 22.1 | 102.0 | 5.1 | 138.1 | 1.00% |
| France | 0.0 | 17.3 | 748.8 | 0.0 | 0.0 | 100.0 | 866.1 | 6.24% |
| Iceland | 0.4 | 0.0 | 0.0 | 0.0 | 0.0 | 0.3 | 0.7 | 0.00% |
| Ireland | 0.0 | 0.0 | 0.0 | 0.0 | 0.3 | 0.0 | 0.3 | 0.00% |
| Italy | 96.0 | 1.6 | 616.0 | 0.0 | 169.0 | 100.0 | 982.6 | 7.08% |
| Japan | 27.0 | 27.0 | 1,894.8 | 0.0 | 0.0 | 150.0 | 2,098.8 | 15.13% |
| Luxembourg | 0.0 | 0.0 | 0.0 | 0.0 | 0.6 | 0.0 | 0.6 | 0.00% |
| Netherlands | 0.0 | 2.3 | 0.0 | 0.0 | 13.1 | 0.0 | 16.2 | 0.12% |
| New Zealand | 0.4 | 0.2 | 60.0 | 0.0 | 0.0 | 0.0 | 60.5 | 0.44% |
| Norway | 7.9 | 1.5 | 47.5 | 1.6 | 0.0 | 0.0 | 58.5 | 0.42% |
| Portugal | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 2.5 | 2.5 | 0.02% |
| Spain | 0.0 | 1.2 | 52.8 | 0.0 | 0.0 | 14.0 | 68.0 | 0.49% |
| Sweden | 0.0 | 0.0 | 153.0 | 51.0 | 0.0 | 10.5 | 214.5 | 1.55% |
| Switzerland | 23.5 | 20.2 | 107.3 | 20.2 | 0.0 | 30.0 | 201.1 | 1.45% |
| Turkey | 1.1 | 0.6 | 216.0 | 0.0 | 0.3 | 1.5 | 219.5 | 1.58% |
| United Kingdom | 24.6 | 127.9 | 25.2 | 0.0 | 0.0 | 100.0 | 277.7 | 2.00% |
| United States | 144.0 | 59.5 | 510.6 | 44.2 | 42.6 | 200.0 | 1,000.9 | 7.21% |
| EEC | 270.0 | 39.6 | 0.0 | 58.8 | 1,113.6 (b) | 0.0 | 1,482.0 | 10.68% |
| EIB | 0.0 | 0.0 | 1,200.0 | 0.0 | 0.0 | 0.0 | 1,200.0 | 8.65% |
| Total | 633.1 | 339.8 | 8,100.8 | 272.8 | 3,510.7 | 1,017.4 | 13,874.6 | 100.00% |
| Percent | 4.56% | 2.45% | 58.39% | 1.97% | 25.30% | 7.33% | 100.00% | |

(a) $798 million grant debt reduction, $1200 million loan economic development
(b) $1044 economic development loan

EUR/EPE 6/90

## G-24 Assistance to Poland and Hungary
## (millions of dollars)

| | Total Assistance | Grant Amount | Grant % of Total | Loan Amount | Loan % of Total |
|---|---|---|---|---|---|
| Total | $12,825.4 | $2,271.3 | 17.7% | $10,554.1 | 82.3% |
| FRG | $4,343.3 | $826.9 | 19.0% | $3,516.4 | 81.0% |
| U.S. | $1,023.0 | $709.0 | 69.3% | $314.0 | 30.7% |
| EEC | $1,540.8 | $150.0 | 9.7% | $1,390.8 | 90.3% |
| UK | $285.7 | $127.9 | 44.8% | $157.8 | 55.2% |
| Denmark | $285.6 | $120.0 | 42.0% | $165.6 | 58.0% |
| Italy | $989.6 | $104.4 | 10.5% | $885.2 | 89.5% |
| Switz. | $203.8 | $67.2 | 33.0% | $136.6 | 67.0% |
| Japan | $2,112.0 | $54.0 | 2.6% | $2,058.0 | 97.4% |
| Canada | $80.0 | $38.3 | 47.8% | $41.8 | 52.2% |
| Austria | $128.8 | $25.0 | 19.4% | $103.8 | 80.6% |
| France | $874.1 | $17.3 | 2.0% | $856.8 | 98.0% |
| Norway | $58.5 | $11.0 | 18.7% | $47.5 | 81.3% |
| Finland | $138.5 | $8.4 | 6.1% | $130.1 | 93.9% |
| Netherld | $14.6 | $6.1 | 41.4% | $8.6 | 58.6% |
| Australia | $5.0 | $4.2 | 83.3% | $0.8 | 16.7% |
| Turkey | $219.7 | $1.4 | 0.6% | $218.3 | 99.4% |
| Iceland | $0.7 | $0.4 | 50.0% | $0.4 | 50.0% |
| Belgium | $170.3 | $0.0 | 0.0% | $170.3 | 100.0% |
| Greece | $0.0 | $0.0 | 0.0% | $0.0 | 0.0% |
| New Zealand | $60.5 | $0.0 | 0.0% | $60.5 | 100.0% |
| Portugal | $2.7 | $0.0 | 0.0% | $2.7 | 100.0% |
| Ireland | $1.3 | $0.0 | 0.0% | $1.3 | 100.0% |
| Sweden | $215.5 | $0.0 | 0.0% | $215.5 | 100.0% |
| Spain | $69.2 | $0.0 | 0.0% | $69.2 | 100.0% |
| Luxembourg | $2.2 | $0.0 | 0.0% | $2.2 | 100.0% |

Based on G-24 PHARE Reports 5/90
EUR/RPE 7/90

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Brussels, 16 May 1990

## OPERATION PHARE

As part of the programme to support the process of economic and social reform under way in Hungary and Poland, the Commission has taken a number of financing decisions on projects in the priority sectors, namely agriculture, investment, the environment and training.[1] Taking into account earlier programmes, the amount of financing from the Community budget now stands at ECU 142 million. ECU 300 million was earmarked in the 1990 budget for direct aid to these two countries, to which must be added EIB and ECSC loans and the counterpart funds raised in Poland from the local sale of food aid, etc.

Most of these operations will be put out for tender and open to all firms of the Community and the two recipient countries. Invitations to tender will soon be published in the appropriate publications, notably the Official Journal of the European Communities.

All these operations, the details of which are given below, are to be finalized by the end of next year.

1. Poland – Environmental protection programme
2. Hungary – Environmental protection programme
3. Community participation in the Regional Environment Centre in Budapest
4. Poland – Programme of basic technical assistance for the privatization programme
5. Hungary – Modernization of the financial system
6. Poland/Hungary – cooperation in the field of economics
7. Poland/Hungary – Technical assistance for the implementation of the Transeuropean Mobility Programme for University Studies (TEMPUS)
8. Poland – Sectoral import programme for animal feeds and animal-feed additives

1 On the basis of proposals presented by Mr Andriessen in liaison Ms Papandreou, Mr McSharry and Mr Ripa de Meana in areas for which they are responsible

1. Poland - Environmental protection programme - ECU 22 million

The short-term aim of the programme is to help Poland develop its environmental monitoring capacity and finance projects designed to reduce emission of pollutants, improve water quality and nature protection, and treat waste.

This initial programme will establish an overall strategy, an environmental protection policy, and, through feasibility studies for new projects, pave the way for future programmes.

The programme will involve:

(a) the setting-up of a fund to finance projects concerning air and water pollution, treatment of waste and the protection of natural sites: the financing will cover the cost of equipment, technical assistance and expenses incurred in implementing the project;

(b) participation in the Project Implementation Unit set up by the World Bank in the ministry concerned.

With regard to air pollution, one of the main pollutants is sulphur dioxide, which is present in great quantities as a result of high lignite consumption and the fact that emissions controls and environmental protection measures are inadequate. The economic crisis has also fuelled lignite consumption and reduced that of more costly energy sources. The worst affected areas are Upper Silesia and Cracow, where sulphur dioxide deposits exceed 100 tonnes/$km^2$.

Domestic heating in the form of individual coal fires is also damaging to the environment, especially since this type of emission is difficult and costly to control. Vehicle exhaust gases are also a subject of concern, though to a lesser degree.

Generally speaking, the monitoring of air pollution, whether of domestic or industrial origin, is inadequate.

Moving to water pollution, no significant progress has been made because the right technology for treating waste water and residues is not available and the industry lacks capital.

Vast quantities of industrial waste are emptied into rivers and the Baltic Sea. Not surprisingly, pollution levels are very high; a third of Polish rivers are too polluted even for industrial use.

The main sources of water pollution are: industrial and domestic waste water, industrial waste, water salinity caused by the coal industry and seepage of chemicals used in agriculture.

The demand for waste-water treatment is enormous since treatment facilities exist in only half the centres of population. The technology requirements are correspondingly enormous.

As to waste treatment, waste is put in open-air dumps without the slightest control. Indeed, waste management, industrial and domestic, is one of the biggest environmental problems facing Poland at present. The disposal of toxic waste, especially chemical waste, in the principal water courses and the use of the sludge as fertilizer are also cause for concern.

Protection of natural sites: an overall strategy is needed to protect the Mazury lakes, also under threat, and help the "new" institutions to take suitable measures.

2. Hungary - Environmental protection programme - ECU 25 million

The short-term objective is to improve Hungary's capacity to monitor the quality of aid and water and to give immediate financing for measures to improve waste disposal, regenerate the ecosystems of lakes, reduce emissions of pollutants and support training in environmental protection. The medium-term objective is to help the authorities responsible for the environment to draw up long-term environmental protection strategies and policies, bolster institutional capacity and lay the foundations for the Community's participation in environmental protection projects by preparing financing programmes.

The programme provides for:

(a) a fund to finance projects in the areas referred to above, which would cover the cost of equipment, technical assistance and other expenses incurred in implementing the programme;

(b) the setting-up of a unit within the ministry to administer the programme; it would include three outside experts to help implement the programme and achieve its objectives.

Decades of economic development based on heavy industry and intensive agriculture, and the lack of any environmental protection policy, have caused alarming levels of pollution in Hungary. Nearly 45% of the population live in areas where air pollution is over the internationally agreed limits and causes a high incidence of respiratory diseases, anaemia, bone abnormalities in children and lung cancer. Sulphur dioxide is one of the main source of pollution (45% exported and 10 tonnes/$km_2$ a year deposited in Hungary itself). Vehicle traffic is increasing the amount of nitrous oxide in towns. Water pollution, brought from neighbouring countries by rivers or generated domestically, is reaching worrying levels. Only half the population is linked to a system for evacuating waste water, and the water distributed to nearly 800 towns and villages has been qualified unfit for human consumption. Surface water and the tributaries of the main rivers are seriously contaminated with mercury, lead and bacteriological agents and there is a great deal of seepage of nitrates into underground water (115 000 tonnes a year). No reliable date is available on the soil but the improper use of fertilizers, atmospheric fallout and waste deposits have pushed the acidity level over the critical threshold of 4.5 pH in some places. Salinity has reached worrying levels over 100 000 ha in a region where the rise of underground water is threatening other irrigated areas.

About 30% of forests are affected, 12% seriously. Waste disposal is a real problem. The some 17 million cubic metres of waste produced each year are put in 2 600 dumps, of which only 58% are deemed to be adequately protected. Hungary imports hazardous waste which it is not adequately equipped to stock.

3. Community participation in the Regional Environment Centre in Budapest - ECU 2 million

Following the initiative to help Eastern and Central Europe deal with their environmental problems, the President of the United States proposed in July 1989 that a Regional Environment Centre should be set up in Budapest with a view to making a major contribution towards saving the region's environment that would go hand in hand with economic restructuring.

By the terms of its charter, the Centre is to be an independent, apolitical, non-profit-making organization. It will sponsor and support seminars, workshops, exhibitions, training courses, exchanges and study awards, and administer and publish a collection of information on the environment;

It would be advisable to make provision for close liaison with the future Community environment agency.

4. Poland - Programme of basic technical assistance for the privatization agency - ECU 9 million

The cornerstone of the liberalization and economic reform process is the break-up and privatization of the estimated 8 000 plus Polish state-held companies. A privatization agency will have the job of drawing up legislation and establishing the necessary procedures and conditions for an orderly and equitable privatization of these state-held companies. The agency will have a double role - preparations for privatization and privatization itself, and creation of a securities market. This will finance technical assistance, training abroad and outside institutional support. The first stage of the project will be implemented in close liaison with the International Finance Corporation.

5. Hungary - Modernization of the financial system - ECU 5 million

The Hungarian Government is engaged in sweeping reforms of policies, institutions and financial instruments, which are an integral part of general process of economic liberalization. Financial reform is seen as a key element of economic restructuring.

Hungary's national bank is negotiating with the World Bank for a loan of some US$ 66 million for the modernization and strengthening of the financial system.

The Community will finance part of the technical assistance and institutional support needed for the modernization programme. The programme will be implemented by the national bank in close cooperation with the World Bank and the Hungarian banking association.

6. Poland/Hungary - Cooperation in the field of economics - ECU 1.5 million

The aim of this cooperation is to promote an exchange of scientific knowledge and expertise in specific economic fields between professional and academic economists of Poland, Hungary and the Community.

The specific fields will concern the process of reform and economic integration, including an analysis of the macroeconomic situation and ways of tackling macroeconomic imbalances, and questions relating to liberalization, integration and microeconomic reform.

Community aid will mainly take the form of grants for research and teaching, research networks and projects and advanced training courses.

7. Poland/Hungary - Technical assistance for the implementation of the Transeuropean Mobility Programme for University Studies (TEMPUS) - ECU 2 million

The aim of the programme is to create a technical assistance instrument for the start-up and initial implementation phase of the TEMPUS programme, starting on 1 May for a period of nine months.

It is planned to establish a central coordinating office to help set up TEMPUS offices in Poland and Hungary, develop administrative procedures for the administration of TEMPUS grants, select projects for this year and establish proper coordination with the relevant authorities within the Community and other countries of the Group of 24.

8. Poland - Sectoral import programme for animal feeds and animal-feed additives - ECU 20 million

This is the second operation to aid Polish agriculture. Under the programme, 40 000 tonnes of animal feed (for pigs and poultry) and various additives to the value of ECU 4 million will be sold to private-sector farmers, who will thus have an opportunity to obtain good quality products at a low price. This will help improve the financial situation of private-sector farmers and boost production of good quality meat.

Technical assistance will be given to help improve the food and health situation and to impart appropriate technology for the animal-feed industry. A study will be carried out to lay down a coherent and effective strategy for the meat sector and food stocks.

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